

Notice of 2003 Annual Meeting and Proxy Statement

2002 Annual Report to Stockholders

2002 Annual Report Consolidated Financial Statements

Annual
Report
Financials

TABLE OF CONTENTS

	<u>Page</u>
Selected Financial Data	1
Management's Discussion and Analysis of Financial Condition and Results of Operations ...	3
Statement of Management Responsibility	35
Report of Independent Accountants	36
Consolidated Statement of Earnings	37
Consolidated Balance Sheet	38
Consolidated Statement of Cash Flows	39
Consolidated Statement of Stockholders' Equity	40
Notes to Consolidated Financial Statements	42
Quarterly Summary	71

SELECTED FINANCIAL DATA
(Unaudited)

	Years Ended October 31,				
	2002	2001	2000	1999	1998
	(in millions, except per share amounts)				
Consolidated Statement of Operations					
Data (1, 2, 3, 4):					
Net revenue	\$ 6,010	\$8,396	\$9,361	\$6,830	\$6,612
(Loss) earnings from continuing operations before taxes	\$(1,547)	\$ (477)	\$1,018	\$ 463	\$ 191
(Loss) earnings from continuing operations	\$(1,022)	\$ (406)	\$ 672	\$ 306	\$ 126
Earnings from discontinued operations, net of taxes	—	6	85	206	131
(Loss) gain from the sale of discontinued operations, net of taxes	(10)	646	—	—	—
(Loss) earnings before cumulative effect of accounting changes	(1,032)	246	757	512	257
Cumulative effect of adopting SFAS No. 133, net of taxes	—	(25)	—	—	—
Cumulative effect of adopting SAB 101, net of taxes	—	(47)	—	—	—
Net (loss) earnings	<u>\$ (1,032)</u>	<u>\$ 174</u>	<u>\$ 757</u>	<u>\$ 512</u>	<u>\$ 257</u>
Net (loss) earnings per share – Basic:					
(Loss) earnings from continuing operations,	\$ (2.20)	\$ (0.89)	\$ 1.49	\$ 0.81	\$ 0.33
Earnings from discontinued operations	—	0.01	0.19	0.54	0.35
(Loss) gain from the sale of discontinued operations, net	(0.02)	1.41	—	—	—
Cumulative effect of adopting SFAS No. 133, net	—	(0.05)	—	—	—
Cumulative effect of adopting SAB 101, net	—	(0.10)	—	—	—
Net (loss) earnings	<u>\$ (2.22)</u>	<u>\$ 0.38</u>	<u>\$ 1.68</u>	<u>\$ 1.35</u>	<u>\$ 0.68</u>
Net (loss) earnings per share – Diluted:					
(Loss) earnings from continuing operations	\$ (2.20)	\$ (0.89)	\$ 1.48	\$ 0.81	\$ 0.33
Earnings from discontinued operations	—	0.01	0.18	0.54	0.35
(Loss) gain from the sale of discontinued operations, net	(0.02)	1.41	—	—	—
Cumulative effect of adopting SFAS No. 133, net	—	(0.05)	—	—	—
Cumulative effect of adopting SAB 101, net	—	(0.10)	—	—	—
Net (loss) earnings	<u>\$ (2.22)</u>	<u>\$ 0.38</u>	<u>\$ 1.66</u>	<u>\$ 1.35</u>	<u>\$ 0.68</u>
Weighted average shares used in computing basic net (loss) earnings per share	465	458	449	380	380
Weighted average shares used in computing diluted net (loss) earnings per share	465	458	455	380	380

	October 31,				
	2002	2001	2000	1999	1998
	(in millions)				
Consolidated Balance Sheet Data (1, 4):					
Working capital	\$ 2,699	\$2,797	\$2,476	\$1,275	\$1,010
Total assets	\$ 8,203	\$7,986	\$8,330	\$5,364	\$4,922
Senior Convertible Debentures	\$ 1,150	\$ —	\$ —	\$ —	\$ —
Stockholders' equity	\$ 4,627	\$5,659	\$5,265	\$3,382	\$3,022

- (1) Consolidated financial data and notes for all periods present our healthcare solutions business as a discontinued operation. See Note 4, "Discontinued Operations" to the consolidated financial statements.
- (2) Loss from continuing operations for the year ended October 31, 2002 includes a pre-tax restructuring charge of \$474 million including a pre-tax asset impairment charge of \$163 million. Loss from continuing operations for the year ended October 31, 2001 includes a pre-tax gain of \$269 million relating to the sale of surplus land in California, a pre-tax restructuring charge of \$154 million primarily relating to severance expenses and a pre-tax asset impairment charge of \$74 million for our customer support software. Earnings from continuing operations for the year ended October 31, 1999 includes a pre-tax asset impairment charge of \$51 million. Earnings from continuing operations for the year ended October 31, 1998 includes a pre-tax restructuring charge of \$155 million. See Note 13, "Restructuring and Asset Impairment," to the consolidated financial statements.
- (3) Consolidated statement of operations data for the year ended October 31, 2001 and 2000 includes the impact of the sale of our portfolio of lease assets to CIT Group Inc. (formerly known as Tyco Capital Corporation). In 2001, net proceeds from this sales transaction were \$287 million and we recognized \$254 million in net revenue from continuing operations and \$131 million in cost of products from continuing operations. In 2000, net proceeds from this sales transaction were \$234 million and we recognized \$197 million in net revenue from continuing operations and \$83 million in cost of products from continuing operations. See Note 5, "Acquisitions and Sale of Assets", to the consolidated financial statements.
- (4) The historical financial data from 1998 through 1999 was carved out from the historical financial information of Hewlett-Packard using the historical results of operations and historical bases of the assets and liabilities of the Hewlett-Packard businesses that comprise our company. We began accumulating retained earnings on November 1, 1999. Therefore, the historical financial data presented for 1998 and 1999 is not indicative of our future performance and does not reflect what our consolidated financial position and results of operations would have been had we operated as a separate, stand-alone entity during those periods.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the consolidated financial statements and notes thereto included elsewhere in this Annual Report. The following discussion contains forward-looking statements including, without limitation, statements regarding our liquidity position and our expected overall growth, the material impact from the adoption of new accounting pronouncements, our financial results, the impact of the enterprise resource planning implementation, savings from restructuring programs, the length of the economic downturn, trends and growth in the markets we sell into, the anticipated completion of transactions and contracts, new product introductions and changes to our manufacturing process that involve risks and uncertainties. Our actual results could differ materially from the results contemplated by these forward-looking statements due to certain factors, including those discussed below in "Factors That May Affect Future Results" and elsewhere in this Annual Report.

Overview

Agilent Technologies, Inc. ("we", "Agilent" or the "Company"), incorporated in Delaware in May 1999, is a global diversified technology organization that provides enabling solutions to technology markets within the communications, electronics, life sciences and chemical analysis industries. Prior to our initial public offering of 16 percent of our stock in November 1999, we were a wholly-owned subsidiary of Hewlett-Packard Company ("Hewlett-Packard"). Hewlett-Packard distributed the remaining 84 percent of our stock to its stockholders on June 2, 2000 in the form of a stock dividend.

Our fiscal year end is October 31. Unless otherwise stated, all years and dates refer to our fiscal year.

Reclassifications

Amounts in the consolidated financial statements as of and for the years ended October 31, 2001 and October 31, 2000 have been reclassified to conform to the presentation in 2002.

Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the U.S. requires that management make a number of assumptions and estimates that affect the reported amounts of assets, liabilities, revenue and expenses in our consolidated financial statements and accompanying notes. Management bases its estimates on historical experience and various other assumptions believed to be reasonable. Although these estimates are based on management's best knowledge of current events and actions that may impact the Company in the future, actual results may differ from these estimates and assumptions.

Our critical accounting policies are those that affect our financial statements materially and involve a significant level of judgment by management. Those policies are revenue recognition, restructuring and impairment charges, inventory valuation, retirement and post retirement plan assumptions, valuation of long-lived assets and accounting for income taxes.

Revenue is recognized on a sale to a customer only after the product or service has been delivered or installed and accepted by the customer. We record reductions to revenue for estimated product returns and distributor price protection, when appropriate. We monitor the creditworthiness of our customers and do not record revenue on sales if collection is not reasonably assured. Most of these conditions are subjective and actual results could vary from the estimated outcome, requiring future adjustments to revenue.

We accrue for restructuring costs when management approves and commits to a firm plan. The three main components of our restructuring plans are related to workforce reductions, the

consolidation of excess facilities and asset impairments, primarily property, plant and equipment. Workforce-related charges are accrued based on an estimate of expected benefits that will be paid out to the employees. Plans to consolidate excess facilities result in charges for lease termination fees and losses anticipated from sub-lease agreements, net of estimated future sublease income. Asset impairment charges are based on an estimate of the amounts and timing of future cash flows related to the expected sales or disposals of buildings and equipment that we currently use in manufacturing, research and development and support. These estimates were derived using the guidance of Statement of Financial Accounting Standards (“SFAS”) No. 121, “Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of” (“SFAS No. 121”), Staff Accounting Bulletin No. 100, “Restructuring and Impairment Charges” (“SAB 100”), and Emerging Issues Task Force No. 94-3, “Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)” (“EITF No. 94-3”). If the amounts and timing are significantly different from what we have estimated, the actual amount could be materially different, either higher or lower, than what we have recorded. However, as of October 31, 2002 and the date of this filing, we believe our estimates remain materially correct. Beginning January 1, 2003, we will follow new guidance provided in SFAS No. 146, “Accounting for Costs Associated with Exit or Disposal Activities” (“SFAS No. 146”). See “New Accounting Pronouncements” below.

We continually assess the valuation of our inventory and periodically write down the value for estimated excess and obsolete inventory based upon assumptions about future demand and market conditions. Such estimates are difficult to make under current volatile economic conditions. Reviews for excess inventory are done on a quarterly basis and required reserve levels are calculated with reference to our projected ultimate usage of that inventory. In order to determine the ultimate usage, we take into account recent sales forecasts, projected obsolescence and our current inventory levels. The excess balance determined by this analysis becomes the basis for our excess inventory charge. Our marketing department plays a key role in our excess inventory review process by providing updated sales forecasts, managing product rollovers and working with manufacturing to maximize recovery of excess inventory. If actual market conditions are less favorable than those projected by management, additional write-downs may be required. If actual market conditions are more favorable than anticipated, inventory previously written down may be sold, resulting in lower cost of sales and higher earnings from operations than expected in that period.

Retirement and post retirement benefit plans are a significant cost of doing business and yet represent obligations that will be ultimately settled far in the future and therefore are subject to estimates. Pension accounting is intended to reflect the recognition of future benefit costs over the employee’s approximate service period based on the terms of the plans and the investment and funding decisions made by us. We are required to make assumptions regarding such variables as the expected long-term rate of return on assets and the discount rate applied to determine service cost and interest cost to arrive at pension income or expense for the year. As of October 31, 2002, the expected long-term rate of return in the U.S. was 8.75 percent, and ranged from 5.5 to 7.75 percent for our plans outside the U.S. We have analyzed the rates of return on assets used and determined that these rates are reasonable based on the plans’ historical performance relative to the overall markets in the countries where the plans are effective. Management will continue to assess the expected long-term rate of return on plan assets assumption for each plan based on relevant market conditions as prescribed by accounting principles generally accepted in the U.S. and will make adjustments to the assumptions as appropriate. A one percent decrease in the estimated return on plan assets would result in increased pension expense of \$10 million for 2003 in the U.S. and \$7 million for 2003 for all plans outside the U.S. Pension expense is allocated to cost of sales, research and development and selling, general and administrative expenses in the consolidated statement of operations. See Note 15, “Retirement Plans and Post Retirement Benefits” to the consolidated financial statements for the full list of assumptions.

We have assessed the recoverability of long-lived assets, including intangible assets, by determining whether the carrying value of such assets will be recovered through undiscounted future cash flows according to the guidance of SFAS No. 121. If the total of future cash flows is less than the carrying amount of the assets, we recognize an impairment loss based on the excess of the carrying amount over the fair value of the assets. Estimates of the future cash flows associated with the assets are critical to these assessments. Changes in these estimates based on changed economic conditions could result in material impairment charges in future periods. Beginning November 1, 2002, we will use the new guidance provided in SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142") and SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"). See "New Accounting Pronouncements" below.

Significant management judgment is required in determining our provision for income taxes and in determining whether deferred tax assets will be realized in full or in part. When it is more likely than not that all or some portion of specific deferred tax assets such as foreign tax credit carryovers will not be realized, a valuation allowance must be established for the amount of the deferred tax assets that are determined not to be realizable. As of October 31, 2002, a valuation allowance for deferred tax assets was not deemed necessary. Accordingly, if the facts or financial results were to change, thereby impacting the likelihood of realizing the deferred tax assets, judgment would have to be applied to determine the amount of valuation allowance required in any given period. We continually evaluate strategies that would allow for the future utilization of our deferred tax assets and currently believe we have the ability to enact strategies to fully realize our deferred tax assets should our earnings in future periods not support the full realization of the deferred tax assets. We have not provided for U.S. federal income and foreign withholding tax on a portion of our non-U.S. subsidiaries' undistributed earnings as of October 31, 2002 because we intend to reinvest such earnings indefinitely. If management decides to remit these earnings to the U.S. in a future period, our provision for taxes may increase materially in that period.

Cyclical Business and General Economic Conditions

The sales of our products and services are dependent, to a large degree, on customers whose industries are subject to cyclical trends in the demand for their products. Shifts in the semiconductor market, electronics industry, computer industry and telecommunications markets, as well as rapidly shifting global economic conditions, have had and will have significant impacts on our businesses.

In 2001, an economic downturn reduced consumer and capital spending in many of the worldwide markets that we serve. This economic downturn has continued in 2002. It also has created an imbalance of supply and demand in the wireless and semiconductor manufacturing industries. In 2002, net revenue was down 28 percent compared to 2001, and we incurred a net loss of \$1,032 million compared to net earnings of \$174 million in 2001. In 2002, loss from continuing operations increased 152 percent compared to 2001. In 2001, net revenue and net earnings were down 10 percent and 77 percent, respectively, compared to 2000. Our earnings from continuing operations in 2000 declined 160 percent to a loss from continuing operations in 2001. Substantially all of the impacts of this decline occurred in our test and measurement and semiconductor products businesses. Wireline telecommunication markets within our test and measurement group continue to decline and a recovery in these markets is not expected for some time. Additionally, as a capital equipment provider, our revenue is driven by the capital expenditure budgets and spending patterns of our customers, who often delay or accelerate purchases in reaction to changes in their businesses and in the economy. We expect some portions of our businesses to remain cyclical in the future. Given that a high proportion of our costs are fixed, variability in revenue as a result of these business cycles could disproportionately affect our quarterly and annual results.

Restructuring and Asset Impairment

Summary

We currently have two active restructuring plans – one initiated in the fourth quarter of 2001 (the “2001 Plan”) and the other initiated in the fourth quarter of 2002 (the “2002 Plan”) after it became clear that the actions taken in the previous year would not be sufficient to return the company to profitability. Both plans were designed to reduce costs and expenses in order to return the company to profitability without relying on an improvement in economic conditions. To date we have achieved savings of approximately \$300 million per quarter, principally through reducing our workforce by 8,000 people.

Actions have been focused on segments that were impacted most severely by the changing environment – our test and measurement and semiconductor products groups – but actions were also taken to reduce the costs associated with support services such as finance and administration. Cost reductions were initiated by reducing the number of properties, particularly sales and administrative sites, and by reducing our workforce within the impacted segments.

Our 2001 Plan was substantially complete as of October 31, 2002. The 2002 Plan is still being implemented – we expect to complete it no later than the first quarter of 2004. We anticipate that we will save an additional \$50 million per quarter by mid 2003 as a result of the 2002 Plan.

The 2001 Plan

In 2001, as a result of the economic downturn that impacted many of the markets that we serve, we took steps to restructure our businesses. On August 20, 2001, we announced a plan to reduce our workforce by approximately 4,000, or about nine percent, by the middle of 2002. On November 15, 2001, we enhanced and supplemented our plan by announcing a further reduction of 4,000 jobs once we had determined that the actions contemplated in August would not be sufficient to return us to profitability. Together these actions form the 2001 Plan, which was designed to reduce costs across almost all of our administrative and support services, including sales and marketing, and to focus our production activities on those products that we believed would return us to profitability, such as those in life sciences, semiconductor test and wireless telecommunications. Our plan impacted the test and measurement group and the semiconductor products group and had little direct impact on the life sciences and chemical analysis group except as the plan related to support services reductions across all of our businesses. Within the test and measurement segment, we reduced production capacity dramatically for communications test product lines and reduced production to some degree in general purpose and semiconductor test product lines. Within the semiconductor products segment we reduced production capacity significantly for product lines in networking, especially long-haul networks, and reduced production capacity for some personal systems products. The 2001 Plan was substantially complete as of October 31, 2002, although we will continue to make lease payments on a number of properties vacated as a result of this plan through at least the next 5 years.

A summary of restructuring activity for the 2001 Plan through October 31, 2002 is shown in the table below:

	<u>Workforce Reduction</u>	<u>Consolidation of Excess Facilities</u>	<u>Impairment of Assets, Property, Plant and Equipment</u>	<u>Total</u>
	(in millions)			
Beginning balance at July 31, 2001	\$ —	\$ —	\$ —	\$ —
Total charge	117	20	17	154
Cash payments	<u>(65)</u>	<u>—</u>	<u>—</u>	<u>(65)</u>
Ending balance at October 31, 2001	52	20	17	89
Total charge	175	53	129	357
Asset impairment	—	—	(146)	(146)
Cash payments	<u>(210)</u>	<u>(10)</u>	<u>—</u>	<u>(220)</u>
Ending balance at October 31, 2002	<u>\$ 17</u>	<u>\$ 63</u>	<u>\$ —</u>	<u>\$ 80</u>

The three main components of the 2001 Plan relate to workforce reductions, consolidation of excess facilities and impairment of property, plant and equipment.

Workforce related charges were incurred as a result of the 8,000-person workforce reduction; the cuts impacted all regions, all expense categories and most of our segments. Research and development activities were terminated on some product development initiatives, none of which were individually or in total significant to our future revenues or profitability. We also took action to reduce the number of employees at production facilities that had experienced declining demand, such as those making equipment for the long-haul wireline business.

Our plan to consolidate excess facilities resulted in charges for lease termination fees and losses anticipated from sub-lease agreements. We have exited, or plan to exit in the near future, more than 100 production, support and sales facilities, or parts of facilities, across all regions, particularly in the U.S. and Japan, representing more than 3.6 million square feet, or about 19 percent, of our worldwide property. As of October 31, 2002, we have vacated approximately 40 percent of these facilities. The decision to exit individual facilities was made as a result of specific economic conditions in certain countries and as part of our strategy to centralize support services and to consolidate facilities. We lease most of these buildings from third parties, and the closures impacted all three of our segments. In most cases, we are exiting office space housing sales and administrative employees. However, a small number of production facilities were closed as a result of our plans to consolidate manufacturing into fewer sites.

Asset impairment charges relate to fixed assets and were determined using estimates of the expected future cash flows generated from those assets. Impairments were recorded for machinery and equipment in production facilities that we were closing or scaling back, such as for the long-haul wireline business and for leasehold improvements in leased facilities that we planned to exit. One production facility in Kobe, Japan accounted for approximately \$60 million of the \$129 million of asset impairment charges in 2002. In order to determine the amount of the impairment, under the held-for-use model in accordance with SFAS No. 121, we estimated the cash flows that would result from our continued use of the building until we expect to vacate it and also estimated the sales proceeds that we expected to be able to realize. The resulting impairment was approximately 80 percent of the net book value of the facility, primarily due to the decline in the local property market.

We have incurred \$511 million of expenses for the 2001 Plan through October 31, 2002: \$154 million in 2001 and \$357 million in 2002. The most significant revision to the plan was made in the fourth quarter of 2002, after updating our lease termination costs and sub-lease income assumptions as the real estate leasing market continued to decline, adding a number of leased

sales offices and two owned production facilities to the list that we were planning to exit, including the facility in Kobe, Japan, described above; we incurred incremental asset impairment costs of \$94 million and lease facility costs of \$36 million in relation to these changes.

We have reduced our workforce by approximately 7,700 (approximately 6,400 from involuntary terminations and approximately 1,300 from net attrition) as of October 31, 2002 and believe we have achieved collective savings of approximately \$880 million in 2002 from the restructuring efforts. Restructuring savings were \$325 million in cost of sales, \$160 million in research and development and \$395 million in selling, general and administrative expenses. We paid approximately \$210 million in cash for severance payments in 2002. The cash payments were funded using cash generated from operations, existing working capital and credit facilities, where necessary.

We expect that future savings of approximately \$1.2 billion per annum will be achieved in total among all types of expenses – cost of products and services, research and development and selling, general and administrative. Savings are expected to be realized from the reductions in salary and benefit expenses, reduction in rent and other facilities costs and from savings associated with materials and supplies. We expect the restructuring plan to have a positive impact on our liquidity in 2003, as the savings generated are predominantly cash.

The 2002 Plan

On August 19, 2002, we announced our intention to further reduce our operational costs by \$50 million per quarter so that we might reach profitability at target revenue levels of \$1.6 billion per quarter. We concluded that we must further reduce our breakeven point given our current level of revenues because the wireline and communications markets are recovering more slowly than we anticipated. This plan primarily affects the manufacturing and field operations serving the wireline markets that are components of our test and measurement group.

A summary of restructuring activity for the 2002 Plan through October 31, 2002 is shown in the table below:

	<u>Workforce Reduction</u>	<u>Impairment of Assets, Property, Plant and Equipment</u> (in millions)	<u>Total</u>
Beginning balance at July 31, 2002	\$ —	\$ —	\$ —
Total charge	83	34	117
Asset impairment	—	(34)	(34)
Cash payments	<u>(15)</u>	<u>—</u>	<u>(15)</u>
Ending balance at October 31, 2002	<u>\$ 68</u>	<u>\$ —</u>	<u>\$ 68</u>

As part of the 2002 Plan we have reduced our workforce by approximately 300 as of October 31, 2002, but collective savings were insignificant in 2002 because the plan implementation began late in the fourth quarter of 2002. We expect to reduce our workforce by 2,500 in total by the time the plan is completed. We expect to achieve the majority of the \$50 million reduction in quarterly operational costs by mid-2003.

Asset impairment charges of \$34 million relate to machinery and equipment, primarily owned by the semiconductor products group in Singapore. The equipment had been purchased in support of communications research but as a result of our restructuring plans we have decided to sell the equipment and conduct the research using existing equipment in the U.S.

A summary of the income statement impact of the combined plans in 2002 and 2001 is shown below. There were no significant restructuring activities in 2000.

	<u>Years ended</u> <u>October 31,</u>	
	<u>2002</u>	<u>2001</u>
	(in millions)	
Cost of products and services	\$210	\$ 79
Research and development	56	17
Selling, general and administrative	<u>208</u>	<u>58</u>
Total restructuring and asset impairment charges.....	<u>\$474</u>	<u>\$154</u>

Other asset impairment charges

In June 2001, we recognized a \$74 million asset impairment charge with respect to our decision to cancel the development of a software system for our customer support activities. We entered into an agreement with Hewlett-Packard to extend our use of their legacy customer support systems in place of the one that we were developing. In 2002, we began to develop a new Customer Relationship Management (“CRM”) system independent from Hewlett-Packard. We expect the CRM to be initially implemented in the first quarter of 2003.



Adoption of New Accounting Standards

In July 2001, we adopted SFAS No. 141, “Business Combinations” (“SFAS No. 141”), which requires that all business combinations initiated after June 30, 2001 be accounted for using the purchase method of accounting and changes the criteria for recognition of intangible assets acquired in a business combination. The impact of adopting SFAS No. 141 was not material to the consolidated financial statements.

Effective November 1, 2000, we adopted SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities” (“SFAS No. 133”), as amended by SFAS No. 138, “Accounting for Certain Derivative Instruments and Certain Hedging Activities”. SFAS No. 133, as amended, establishes accounting and reporting standards for derivative instruments, and requires that all derivatives be recognized as either assets or liabilities on the balance sheet and carried at fair value. Changes in the fair value of the derivative instruments are recognized in earnings or stockholders’ equity, depending on the intended use of the instrument. The adoption of SFAS No. 133 in November 2000 resulted in a cumulative pre-tax reduction in earnings of \$41 million (\$25 million after-tax) primarily relating to the valuation of warrants to purchase securities and a pre-tax increase in other comprehensive income of \$10 million.

In December 1999, the Securities and Exchange Commission (“SEC”) issued Staff Accounting Bulletin No. 101, “Revenue Recognition in Financial Statements” (“SAB 101”). During the fourth quarter of 2001, we adopted SAB 101 retroactive to the beginning of the fiscal year. The cumulative effect of the adoption, reflecting the deferral of net revenue and cost of products from October 31, 2000, resulted in a cumulative pre-tax reduction in earnings of \$74 million (\$47 million after tax). As a result of adopting SAB 101, delivery is considered to have occurred when title and risk of loss have transferred to the customer. For the fiscal year ended October 31, 2001, the net impact on 2001 net revenue, including amounts deferred at October 31, 2001, was an increase of \$67 million of net revenue and \$29 million of cost of products which were included in the cumulative effect adjustment. The results for the first three quarters of 2001 have been restated in accordance with SAB 101. Pro forma amounts for the year ended October 31, 2000 have not been presented, as the effect of the change could not be reasonably determined.

New Accounting Pronouncements

In July 2001, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 142 under which goodwill will no longer be amortized but reviewed annually (or more frequently if impairment indicators arise) for impairment. We adopted SFAS No. 142 on November 1, 2002. Subsequently, we are required to evaluate our existing goodwill and intangible assets and make any necessary reclassification in order to comply with the new criteria in SFAS No. 142. Based on our assessment, effective in the first quarter of 2003, approximately \$6 million of intangible assets associated with workforce-in-place will be reclassified to goodwill.

As part of our assessment, we used the fair value measurement requirement, rather than the previously required undiscounted cash flows approach, and as a result we expect to record a transitional impairment loss from the implementation of SFAS No. 142 as a change in accounting principle in the first quarter of 2003. The fair value of the reporting units was determined primarily by the income approach, which estimates the fair value based on the future discounted cash flows. The first step evaluation of reporting units on a fair value basis, as required by SFAS No. 142, indicated that an impairment exists in the communications solutions reporting unit within our test and measurement business. The revenue forecasts of the communications solutions reporting unit have been impacted by the prolonged economic downturn in the communications test markets. We were required to perform the second step analysis to determine the amount of the impairment loss for the reporting unit that failed the first step test. The second step analysis consisted of comparing the implied fair value of the reporting unit’s goodwill with the carrying amount of the reporting unit’s goodwill, with an impairment charge resulting from any excess of the carrying value of the reporting unit’s goodwill over the implied fair value of the reporting unit’s goodwill. Based upon this evaluation, the pre-tax impairment is expected to be \$268 million, approximately 44 percent of total consolidated goodwill recorded as of October 31, 2002. The adoption of SFAS No. 142 is also expected to have a material impact on our results of operations because goodwill will no longer be amortized subsequent to the adoption of SFAS No. 142. Amortization of goodwill was \$326 million in 2002, \$303 million in 2001 and \$64 million in 2000.

In August 2001, the FASB issued SFAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets” (“SFAS No. 144”). SFAS No. 144 amends existing accounting guidance on asset impairment and provides a single accounting model for long-lived assets to be disposed of. Among other provisions, the new rules change the criteria for classifying an asset as held-for-sale. The standard also broadens the scope of businesses to be disposed of that qualify for reporting as discontinued operations, and changes the timing of recognizing losses on such operations. We will adopt SFAS No. 144 in the first quarter of 2003. We do not believe that the adoption will have a material impact on our consolidated financial position, results of operations or cash flows.

In July 2002, the FASB issued SFAS No. 146, which nullifies EITF No. 94-3. SFAS No. 146 requires that a liability be recognized for restructuring costs only when the liability is incurred, that is, when it meets the definition of a liability in the FASB’s conceptual framework. SFAS No. 146 also establishes fair value as the objective for initial measurement of liabilities related to exit or disposal activities and is effective for exit or disposal activities that are initiated after December 31, 2002, with earlier adoption encouraged. The effect of adoption is dependent on the timing of our related restructuring activities; however, we do not believe that the adoption of SFAS No. 146 will have a material impact on our consolidated financial position, results of operations or cash flows.

Acquisitions

On January 5, 2001, we acquired Objective Systems Integrators, Inc. (“OSI”) for approximately \$716 million. Of this total, \$690 million was cash and the remainder represents the fair value of options granted. Using the purchase method of accounting in accordance with Accounting

Principles Board (“APB”) Opinion No. 16, “Business Combinations” (“APB No. 16”), the purchase price was allocated to tangible and intangible assets including goodwill. The original goodwill balance of \$593 million was being amortized over three years. The net book value of goodwill associated with this acquisition at October 31, 2002 was \$234 million. At the time of acquisition, OSI was a leading provider of next-generation operations-support-system software for communications service providers and has become part of our test and measurement business.

In July 1999, Hewlett-Packard entered into an agreement with Yokogawa Electric Corporation (“Yokogawa”) to acquire Yokogawa’s 25 percent equity interest in Agilent Technologies Japan, Ltd. for approximately \$521 million (the “Yokogawa Purchase”). The acquisition was done in several steps. In the initial step, which occurred in January 2000, we purchased approximately 10 percent of Agilent Technologies Japan, Ltd. shares from Yokogawa for approximately \$206 million. In the second step, which occurred in April 2000, we purchased approximately 11 percent of additional Agilent Technologies Japan, Ltd. shares from Yokogawa for approximately \$216 million. In January 2001, we completed the Yokogawa Purchase by purchasing the remaining 4 percent interest for approximately \$99 million. Of the total purchase price, \$243 million was allocated to tangible assets and \$278 million was attributed to goodwill and was being amortized over ten years. The remaining net book value of goodwill associated with this acquisition was \$205 million at October 31, 2002.

In addition to the OSI acquisition and the Yokogawa Purchase, we acquired several other companies during 2002, 2001 and 2000, which were not significant to our consolidated financial position, results of operations or cash flows. These acquisitions were accounted for under the purchase method of accounting as defined in APB No. 16 or SFAS No. 141 depending on the date of acquisition. The results of operations of the acquired companies were included prospectively from the date of acquisition and the acquisition cost was allocated to the acquired tangible assets and liabilities and identifiable intangible assets based on fair values at the date of acquisition. Residual amounts were recorded as goodwill. In-process research and development write-offs have not been significant.

Unaudited pro forma statement of operations information has not been presented because the effects of these acquisitions were not material on either an individual or an aggregated basis.

The net book value of goodwill was \$610 million at October 31, 2002 and \$944 million at October 31, 2001. Goodwill related to acquisitions completed prior to June 30, 2001 was amortized over periods ranging from three to ten years. Effective in the first quarter of 2003, goodwill will no longer be amortized, in accordance with our adoption of SFAS No. 142. The aggregate amount of goodwill impairment losses was \$12 million in 2002, \$8 million in 2001 and insignificant in 2000. See further discussion in “New Accounting Pronouncements” above.

Amortization of purchased intangible assets was \$52 million in 2002, \$41 million in 2001 and \$7 million in 2000. The carrying amount of purchased intangibles was \$75 million as of October 31, 2002. Effective in the first quarter of 2003, approximately \$6 million of workforce-in-place will be reclassified from intangible assets to goodwill. The remaining intangible assets of \$69 million will be amortized as follows: \$46 million in 2003 and \$23 million in 2004.

Discontinued Operations

On August 1, 2001, we completed the sale of our healthcare solutions business to Koninklijke Philips Electronics, N.V. (“Philips”) pursuant to an Asset Purchase Agreement for a total purchase price of \$1.7 billion. Philips paid initial proceeds of \$1.6 billion to us on August 1, 2001, with further payments following pursuant to the terms of the Asset Purchase Agreement dated as of November 17, 2000, as amended and supplemented by the Amendment and Supplemental Agreement, dated as of August 1, 2001 (collectively, the “Asset Purchase Agreement”). The total purchase price was subject to adjustment based on the determination of the final purchased net assets and on our performance of integration services for Philips.

Our consolidated financial statements reflect our healthcare solutions business as discontinued operations in accordance with APB Opinion No. 30 "Reporting the Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions" ("APB No. 30"). The financial position, results of operations and cash flows of our healthcare solutions business have been classified as discontinued and prior periods have been restated, including the reallocation of general overhead charges to our three remaining business segments. We recorded an after-tax gain of \$646 million in 2001 and an after-tax loss of \$10 million in 2002 as a result of the sale to Philips. In 2002, adjustments were made to the gain as a result of purchase price adjustments to reflect the final purchased net assets and additional costs that were not anticipated at the time of the sale.

We signed an agreement with Philips, dated as of May 15, 2002, finalizing the purchase price adjustments from the sale. The adjustments did not result in a material adjustment to the gain on sale. Since August 1, 2001, we received all of the \$100 million withheld by Philips from the total purchase price at the time of the sale plus adjustments for the final purchased net assets. For incremental fees, we provided support services to Philips after August 1, 2001 and a portion of these fees offset costs that include an element of fixed costs which are recognized in selling, general and administrative expenses in 2001 and 2002. As of October 31, 2002, we have completed our contractual obligation to provide services to Philips.

Under the Asset Purchase Agreement, we are restricted from competing in the development, manufacturing, selling or servicing of certain medical products for five years after the sale. We do not expect any material impact on our financial position, results of operations or cash flows from this non-compete agreement because we do not intend to engage in those specified businesses.

Asset Sales

Sale of Leasing Portfolio

In the fourth quarter of 2000, we entered into an asset purchase agreement with CIT Group Inc. ("CIT," formerly Tyco Capital Corporation) pursuant to which we sold them substantially all of our leasing portfolio (the "CIT Group Sale") over the course of 2000 and 2001. There was no impact on our consolidated cash flows and results of operations for the CIT Group Sale in 2002. The impact on our consolidated cash flows and results of operations of the CIT Group Sale in the previous two years is shown below.

	<u>Year Ended</u> <u>October 31, 2001</u>	<u>Year Ended</u> <u>October 31, 2000</u>
	(in millions)	
Net proceeds from the CIT Group Sale	\$287	\$234
Product revenue	254	197
Cost of products	131	83

We also entered into a vendor financing arrangement with CIT whereby CIT will provide equipment financing and leasing services to our customers on a global basis. This agreement has been in place since the fourth quarter of 2000.

In addition to the CIT Group Sale and the sale of the healthcare solutions business, we sold assets related to portions of our businesses to third parties during 2002, 2001 and 2000. Gross proceeds from these dispositions were \$31 million in 2002, \$13 million in 2001 and insignificant in 2000. Gains from the dispositions, included in other income (expense), net, in the consolidated statement of operations, were \$15 million in 2002, \$9 million in 2001 and insignificant in 2000.

Sale of San Jose Land

In February 2001, we sold a parcel of surplus land in San Jose, California for \$287 million in cash, resulting in a pre-tax gain of approximately \$269 million. In August 2001, we invested in the

leasehold of several municipal properties in southern California for a total value of \$289 million. In 2002, we received \$237 million in non-refundable prepaid rent related to the investment in leaseholds as described above.

Foreign Currency

We are exposed to changes in foreign currency exchange rates as a result of our global operating and financing activities. Our foreign currency exposures are hedged as part of our global risk management program, which is designed to minimize short-term exposure to foreign currency fluctuations. Movements in exchange rates net of our hedging activities had no material effect on our operations in the periods presented.

Effective November 1, 2001, we have determined that the functional currency for many of our subsidiaries outside the U.S. has changed from the U.S. dollar to local currency based on the criteria of SFAS No. 52 "Foreign Currency Translation". This change did not have a material impact on our consolidated financial position as of November 1, 2001.

Results of Continuing Operations

Results from operations declined for a second year to a \$1,607 million loss in 2002 from a \$778 million loss in 2001 and \$924 million in earnings in 2000. This trend generally followed the continuing decline in orders to \$6,013 million in 2002 from \$6,414 million in 2001 and \$10,566 million in 2000. In response to declining orders and revenue, beginning in 2001, we took a number of steps to reduce our overall cost structure. We began the 2001 Plan in the fourth quarter of 2001 and continued it through 2002. The 2001 Plan resulted in a workforce reduction of 7,700 including normal attrition, and a further reduction of 2,500 was announced in the 2002 Plan. Primarily as a result of approximately \$880 million in restructuring savings from efforts in the 2001 Plan, total costs and expenses declined in 2002 to \$7,617 million from \$9,174 million in 2001. After adjusting for the differences in inventory charges and the costs of restructuring, total costs and expenses declined approximately \$1,458 million year-over-year in 2002, despite an increase of \$89 million related to our Enterprise Resource Planning (ERP) and Customer Relationship Management (CRM) software initiatives in 2002.

Although we are cautiously optimistic about the recent growth in our quarterly revenue, with the fourth quarter of 2002 representing our best performance since the third quarter of 2001, quarterly orders remained stagnant at around \$1,500 million throughout 2002. We have therefore concluded that we must further reduce our cost structure in 2003 and have announced the 2002 Plan, which began in the fourth quarter of 2002. The effort is designed to reduce our overall cost structure by an additional \$50 million per quarter beginning in the second half of 2003.

We currently do not expect a major upturn in orders or revenue in the first six months of 2003. We intend to continue to reduce our costs and expenses and reach breakeven in our cash flows from operations in 2003. We also do not expect significant disruptions in our business from completing our ERP and CRM implementations in 2003. We did experience some slowdown and loss of orders during third quarter of 2002 related to our ERP implementation, which we substantially recovered in our fourth quarter. We believe that the risk of future material order and revenue losses is not significant.

Orders and Net Revenue

	Years Ended October 31,			2002 over 2001 % Change	2001 over 2000 % Change
	2002	2001	2000		
	(in millions)				
Orders	\$6,013	\$6,414	\$10,566	(6)%	(39)%
Net Revenue:					
Products	\$5,234	\$7,485	\$ 8,300	(30)%	(10)%
Services and other	776	911	1,061	(15)%	(14)%
Total net revenue	<u>\$6,010</u>	<u>\$8,396</u>	<u>\$ 9,361</u>	(28)%	(10)%
	Years Ended October 31,			2002 over 2001	2001 over 2000
	2002	2001	2000	Ppts Change	Ppts Change
% of Total Net Revenue Products	87%	89%	89%	(2)	—
Services and other	13%	11%	11%	2	—
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>	—	—
	Years Ended October 31,			2002 over 2001	2001 over 2000
	2002	2001	2000	% Change	% Change
	(in millions)				
Net Revenue by Region					
U.S.	\$2,355	\$3,373	\$ 3,992	(30)%	(16)%
International	3,655	5,023	5,369	(27)%	(6)%
Total	<u>\$6,010</u>	<u>\$8,396</u>	<u>\$ 9,361</u>	(28)%	(10)%

Orders in 2002 declined compared to 2001 primarily due to continued weakness in telecommunications markets, which primarily affected our test and measurement business, but the decline was offset by orders growth in our semiconductor products and life sciences and chemical analysis businesses. Orders in 2001 compared to 2000 declined due to dramatic overall declines in the telecommunications, semiconductor and computer industries. Going into 2003 we will be relying primarily on new products to drive orders growth.

Net revenue declined in 2002 as compared to 2001 primarily due to continued weakness in key market segments, particularly wireless and wireline telecommunications, as well as pricing pressures from both customers and competitors in the face of a weak economy. Declines outside the U.S. were slightly lower than domestically in part due to our customers buying infrastructure products in Asia. Continued slow markets in communications drove declines in product revenue; declines in service revenue were driven by reduced contract renewal rates as an increasingly large portion of our customers have elected to receive service on a time-and-materials basis. Services and other includes revenue generated from servicing our installed base of products, warranty extensions and consulting in all years, in addition to operating lease revenue in 2001 and 2000.

Excluding the CIT Group Sale of \$254 million in 2001 and \$197 million in 2000, net revenue for 2001 decreased 11 percent compared to 2000. The decrease related primarily to the slowdown in the telecommunications, semiconductor and computer industries, which severely impacted our customers' ability to purchase our products. The decrease in domestic net revenue for 2001 came primarily from our businesses that serve the communications and electronics markets; the slowdown in those markets impacted our net revenue in the U.S. somewhat more severely than other parts of the world. The decrease in product revenue for 2001 was driven primarily by the slowdown in communications and electronics markets. The decline in service revenue for 2001 was primarily the result of the CIT Group Sale and the decline in service contract renewal rates.

Generally, there is a lag between service revenue trends and product revenue trends; this lag occurs because service revenue is directly related to the size of our installed base of products not covered by warranty.

Costs and Expenses

<u>As a % of Net Revenue</u>	<u>Years Ended October 31,</u>			<u>2002 over 2001</u> <u>Ppts Change</u>	<u>2001 over 2000</u> <u>Ppts Change</u>
	<u>2002</u>	<u>2001</u>	<u>2000</u>		
Cost of products as a percentage of product revenue	62%	59%	49%	3	10
Cost of services and other as a percentage of services and other revenue	58%	50%	51%	8	(1)
Total costs as a percentage of total net revenue	61%	58%	49%	3	9
Research and development	19%	15%	11%	4	4
Selling, general and administrative	46%	36%	30%	10	6

Cost of products and services as a percentage of net revenue increased in 2002 compared to 2001, despite decreases in the actual dollar amounts of costs, due to the steep decline in revenue we experienced this year. Our fixed costs relating to continued overcapacity increase as a percentage of net revenue with any decline in net revenue. Savings in dollar terms were primarily the result of the 2001 Plan, which yielded approximately \$325 million of savings in cost of products and services for the year, and reduced inventory charges. Excluding the CIT Group Sale and restructuring charges of \$79 million in 2001, cost of products and services as a percentage of net revenue for 2001 increased 10 percentage points compared to 2000. The increase was primarily attributable to decreased sales volume and increased charges for excess and obsolete inventory. During 2001, cost of products as a percentage of product revenue increased due to the same factors mentioned above and higher discounts offered to our customers. Discount increases affected the majority of our products and were the result of pressure from competitors and customers in the face of a declining economy.

Inventory charges totaled \$40 million in 2002 compared to \$459 million in 2001 and \$70 million in 2000. The abnormally high charges in 2001 compared to 2000 and 2002 were the result of the rapid and steep market decline that year, which caused excess inventory of then-current products and hastened the obsolescence of older products. Inventory charges in 2001 spanned the vast majority of our products as well as raw materials. Additional charges in 2002 reflected continuing weakness in some of our largest markets, particularly telecommunications, but were partially offset by the sale of inventory previously written off in our semiconductor product lines.

Research and development expenses as a percentage of net revenue increased in 2002 compared to 2001 as a direct result of decreased revenue; in 2001 compared to 2000 research and development expenses increased in both dollar terms and as a percentage of net revenue as a result of continuing expenditures toward new product introductions, many of which helped to offset our revenue losses in the current year. Our research and development efforts focus on potential new products and product improvements covering a wide variety of technologies, none of which is individually significant to our operations. We conduct five types of research and development: basic research, which contributes to the fundamental understanding of areas critical to our future; foundation technologies research, which enables fundamental advances across all businesses; communications research, which creates technologies to enable pervasive access to information; life sciences research, which enables next-generation pharmaceuticals and improved patient outcomes; and measurement research, which provides critical advances in test and measurement electronics and systems. Our research improves on various technical competencies in electronics such as compound semiconductor devices, digital imaging systems and microfabrica-

tion technologies; systems and solutions such as applied mathematics, knowledge management and measurement science; life sciences such as computational biology, molecular diagnostics and high-throughput measurements; and photonics, such as precision automation technology, optical switching and high-speed optical links. In each of these research fields, we conduct research that is focused on specific product development for release in the short-term and other research that is intended to be the foundation for future products over a longer time horizon. A significant portion of our product development research is designed to improve on the more than 20,000 products already in production, and other research is on major new product releases. Because of the large number of new and existing products and research and development projects across all of our businesses, it is difficult to quantify the impact of any specific products or projects.

Selling, general and administrative expenses as a percentage of net revenue increased in 2002 compared to 2001, despite reductions in overall spending, due to the significant decline in net revenue. Overall our spending on selling, general and administrative expenses in 2002 was \$250 million lower than in 2001, despite an increase of approximately \$89 million in expense for our ERP and CRM systems as a result of savings from the 2001 Plan. Selling, general and administrative expenses as a percentage of net revenue increased in 2001 compared to 2000 primarily due to goodwill amortization relating to our 2001 acquisition of OSI. As a result of various expense-control initiatives in 2001, selling, general and administrative expenses before the effect of goodwill and other intangible amortization, restructuring and asset impairment charges declined 12 percent compared to 2000.

(Loss) Earnings from Operations

	<u>Years Ended October 31,</u>			<u>2002 over 2001</u>	<u>2001 over 2000</u>
	<u>2002</u>	<u>2001</u>	<u>2000</u>		
	(in millions)				
(Loss) earnings from operations	\$(1,607)	\$(778)	\$924	(107)%	(184)%
Operating (deficit) margin	(27)%	(9)%	10%	(18) points	(19) points

Our increased loss from operations in 2002 compared to 2001 was a direct result of the decline in revenue that we experienced, as well as increases in restructuring and asset impairment charges related to restructuring. However, we demonstrated considerable success in realigning our businesses to the weakened economic conditions; the increase of \$829 million in our loss from operations was less than 35 percent of our total revenue decline of \$2,386 million.

Excluding the CIT Group Sale, we had a loss from operations of \$901 million in 2001 compared to earnings from operations of \$810 million in 2000. Excluding the restructuring charges and the CIT Group Sale, we had a loss from operations of \$447 million in 2001 compared to earnings from operations of \$925 million in 2000. The decrease in 2001 compared to 2000 was primarily due to the fact that net revenue declined much more rapidly than costs and expenses in the test and measurement and semiconductor businesses. Increased goodwill amortization related to recent acquisitions also contributed to the decrease. The decrease was partially offset by the performance of our life sciences and chemical analysis business.

Other Income (Expense), Net

	<u>Years Ended October 31,</u>			<u>2002 over 2001</u>	<u>2001 over 2000</u>
	<u>2002</u>	<u>2001</u>	<u>2000</u>		
	(in millions)				
Other income (expense), net	\$60	\$301	\$94	(80)%	220%

Excluding the \$269 million impact of the sale of land in San Jose, California in 2001, other income (expense), net increased \$28 million in 2002 compared to 2001. This net increase was due to: \$45 million from reduced losses on equity investments, \$31 million from increased interest income from cash deposits and reduced interest expense due to the pay down of commercial

paper and \$6 million from gains from dispositions. These increases were partially offset by: \$35 million due to interest payable on convertible debt issued in 2002, \$4 million due to currency movement and \$15 million due to various items, none of which was individually material. Other income (expense), net increased \$207 million in 2001 over 2000. The increase was primarily due to the sale of land in San Jose, California, which resulted in a pre-tax gain of \$269 million. The increase in other income (expense), net for 2001 compared to 2000 was partially offset by higher interest expense due to a higher average debt balance.

We sold assets related to portions of our businesses to third parties during 2002, 2001 and 2000. Gross proceeds from these dispositions were \$31 million in 2002, \$13 million in 2001 and insignificant in 2000. Gains from the dispositions, included in other income (expense), net in the consolidated statement of operations, were \$15 million in 2002, \$9 million in 2001 and insignificant in 2000.

(Benefit) Provision for Taxes

The effective tax benefit rate for continuing operations in 2002 was 34 percent. For 2001 and 2000, the effective rates were 19 percent and 34 percent, respectively.

In 2002, the higher benefit tax rate was due to the relatively higher loss from continuing operations in 2002 than in 2001. In 2001 compared to 2000, the change in the tax rate for continuing operations was due to the tax benefits arising from the losses caused by the global economic downturn of that year. Taxes on the sale of our healthcare solutions business in 2001 were reflected in the gain from sale of discontinued operations.

Our future effective tax rate will continue to be calculated using our pre-tax earnings or loss and will be affected by additional research and development tax credits, the expected level of other tax benefits, the effects of business acquisitions and dispositions as well as changes in the mix of our pre-tax earnings among jurisdictions with varying statutory rates.

Segment Results

For 2002, we changed the method by which we allocate corporate expenses to the segments. Prior period (loss) earnings from operations have been restated accordingly. Management measures the profitability of each of the business segments after excluding goodwill and other intangible amortization and non-recurring items such as restructuring charges; these items have been excluded for all periods presented.

Test and Measurement

Our test and measurement business provides standard and customized solutions that are used in the design, development, manufacture, installation, deployment and operation of electronic equipment and systems and communications networks and services. Overall orders activity over the last 12 quarters indicates that the markets for our test and measurement products were fairly consistent throughout 2000, dropped dramatically during 2001 and have remained depressed in 2002 with some unusually steep quarterly variations through the year. Within the business, orders trends were mixed, with our automated test products showing a slight rebound in 2002 compared to 2001 while the other product lines trended downward similarly to the overall results for the business. Generally speaking, declines in both years were the result of a weak market for telecommunications products, with offsetting growth in 2002 driven by orders from semiconductor contract manufacturers in the U.S. and Asia, particularly for our system-on-a-chip products.

Orders and Net Revenue

	Years Ended October 31,			2002 over 2001 Change	2001 over 2000 Change
	2002	2001	2000		
	(in millions)				
Orders	\$3,294	\$4,021	\$7,002	(18)%	(43)%
Net revenue from products	\$2,791	\$4,763	\$5,299	(41)%	(10)%
Net revenue from services and other ...	<u>527</u>	<u>669</u>	<u>809</u>	(21)%	(17)%
Total net revenue	\$3,318	\$5,432	\$6,108	(39)%	(11)%
(Loss) earnings from operations	(837)	(120)	756	(598)%	(116)%
Operating margin (deficit)	(25)%	(2)%	12%	(23) points	(14) points

The declines in orders in 2002 compared to 2001 and in 2001 compared to 2000 followed overall trends in the markets where this business focuses its sales, and were driven primarily by weakness in the telecommunications market. However, despite the declines over the prior two years we feel well positioned going into 2003, as we have made major strides toward stabilization since implementing our Enterprise Resource Planning software platform and our products are well positioned to take advantage of the growth anticipated in China as that market continues to open in the near future. Generally speaking, the outlook for wireless communications test products is beginning to improve, while wireline products are anticipated to have a difficult year and we expect the market for general-purpose test products to be mixed. Overall, we will rely on new products for orders growth in the coming year, both to take share in limited new market opportunities and to gain share in larger existing markets.

The decline in net revenue for 2002 compared to 2001 was primarily the result of the slowdown in the telecommunications industry, as was the decline in 2001 compared to 2000. The slowdown was particularly sharp in the second half of 2001 as we became increasingly dependent on incoming orders, which declined in virtually all of the product lines of our test and measurement businesses. Excluding the CIT Group Sale, total net revenue for 2001 declined 12 percent compared to 2000. Pricing pressures from customers and competitors including sales of used equipment by customers either downsizing or going out of business also contributed to the decline in revenue in 2002 compared to 2001. Overall discounts have increased by approximately 4 percentage points since the beginning of 2001, resulting in approximately \$150 million less revenue in 2002 compared to 2001. Our percentage of revenue from new products increased approximately 20 percentage points since early 2001; in 2002 we introduced more than 100 new products, nearly a quarter of which have significant strategic and financial impact on our business. These new products include vector network analyzers, optical electrical generators, performance signal analyzers and automated performance characterization testing products. Net revenue from services and other declined less dramatically than product revenue in 2002 compared to 2001 despite customers increasingly moving away from contracts and towards service on a time-and-materials basis; service revenue is generally more stable than product revenue in difficult market conditions as our installed base of products continues to generate service needs. Net revenue from services and other decreased more dramatically than net revenue from products for 2001 compared to 2000 primarily due to the CIT Group Sale. In addition, a number of customers chose not to renew their service contracts in 2001 in response to cost constraints due to the difficult economic conditions that year.

Costs and Expenses

The following table shows the percentage point increase in our test and measurement business' costs and expenses as a percentage of net revenue for 2002, 2001 and 2000.

<u>Increase as a % of Net Revenue</u>	<u>2002 over 2001 Ppts Change</u>	<u>2001 over 2000 Ppts Change</u>
Cost of products and services	3	9
Research and development	7	3
Selling, general and administrative	13	2

Cost of products and services as a percentage of net revenue increased in 2002 over 2001 primarily due to the overall decrease in net revenue. On a dollar basis, costs were down 35 percent for the year, driven primarily by savings from restructuring and reduced inventory charges. Cost of products and services as a percentage of net revenue increased in 2001 compared to 2000 primarily due to increased charges for excess and obsolete inventory. Excluding the impact of inventory charges, cost of products and services as a percentage of net revenue increased 3 percentage points in 2001 from 2000. Due to the fixed nature of our manufacturing costs, lower than anticipated manufacturing volumes contributed to the increase in cost of products and services as a percentage of net revenue.

Inventory charges totaled \$54 million in 2002 compared to \$364 million in 2001 and \$57 million in 2000. The large increase from 2000 to 2001 was the result of rapidly deteriorating conditions in the telecommunications and electronics markets; the charges affected parts for the majority of all product types. Additional charges in 2002 are closer to our run-rate in 2000, and particularly reflect continuing weakness in the communications test market even beyond our expectations at the end of 2001. Inventory charges in 2002 primarily affected optical communications measurement products, demo inventory and raw materials.

Research and development expense as a percentage of net revenue increased in 2002 from 2001 due to the overall decrease in net revenue. On a dollar basis, expenses were down 10 percent for the year, predominantly as a result of restructuring and from delays and reductions in new product introductions that would otherwise have been developed for near-term release. Specifically, our research and development funding has been refocused to take advantage of the markets that are beginning to recover from the declines or stagnation of the last several quarters, while reductions have been targeted to products in markets that are particularly weak and not expected to recover in the near term, such as wireline telecommunications. The increase in research and development expenses as a percentage of net revenue in 2001 compared to 2000 was primarily due to our continuing expenditures toward new product introductions that were anticipated to generate material contributions to revenue in future periods, combined with the decrease in overall net revenue.

Selling, general and administrative expenses as a percentage of net revenue increased in 2002 compared to 2001 due to the overall decrease in net revenue. On a dollar basis, expenses were down 16 percent primarily as a result of restructuring. In 2001 selling, general and administrative expenses as a percentage of net revenue were flat compared to 2000.

(Loss) Earnings from Operations

Our reduced revenue drove the increase in loss from operations in 2002 compared to 2001; weak sales overcame significant new product wins and restructuring savings during the year. However, the fact that losses increased only \$1,027 million after removing the impact of reduced inventory charges, compared to reduced revenue of \$2,114, is a sign that our restructuring efforts have had significant success in reducing our overall cost structure. The 2001 Plan saved approximately \$600 million in 2002 and we reduced average headcount by 11 percent. The 2002 Plan will be focused on achieving breakeven or profitability for the business in 2003, including an

additional reduction in average headcount of 8 percent and incremental savings of approximately \$40 million per quarter by the end of the year. The savings will result from both the reduction in employee-related costs and from shifting manufacturing and sales into lower-cost regions.

Loss from operations in 2001 was a result of reduced demand, which led to fewer sales and increased charges for excess and obsolete inventory. Excluding the CIT Group Sale, loss from operations was \$242 million compared to earnings from operations of \$644 million in 2000.

Semiconductor Products

Our semiconductor products business is a leading supplier of semiconductor components, modules and assemblies for high performance communications systems. We design, develop and manufacture products for the networking and personal systems markets. Overall orders activity over the last 12 quarters indicates that the markets for our semiconductor products declined slightly during 2000, dropped dramatically during 2001 with an abnormally low bottom point near the middle of the year, and improved again gradually in 2002. The average for 2002 was just under two-thirds the average in 2000. Underlying market conditions remain little changed in 2002 compared to 2001, including continuing pricing pressure on the orders we book, which is demonstrated by our steadily declining revenue for the same comparison periods despite the orders increase in the current year.

Orders and Net Revenue

	Years Ended October 31,			2002 over 2001 Change	2001 over 2000 Change
	2002	2001	2000		
	(in millions)				
Orders	\$1,568	\$1,290	\$2,511	22%	(49)%
Net revenue	\$1,559	\$1,850	\$2,213	(16)%	(16)%
(Loss) earnings from operations	(68)	(177)	229	62%	(177)%
Operating (deficit) margin	(4)%	(10)%	10%	6 points	(20) points

The overall increase in orders for 2002 compared to 2001 was the result of growth in our personal systems product lines, partially offset by reductions in our networking product lines. In personal systems, we saw orders growth of 50 percent for our imaging products and 33 percent for general optoelectronic components while orders for our wireless products were flat from the prior year. In networking, our optical products declined 11 percent compared to the prior year while our smaller overall orders for integrated circuits grew 20 percent. There is still no indication of stabilization in the telecommunications market, but other markets for our networking products show potential for growth in the coming year. The decline in orders for 2001 compared to 2000 was a direct reflection of the steep and rapid decline in the semiconductor products marketplace that year. Looking forward, geographical trends in orders show growth in Asia as an increasing number of companies shift manufacturing out of North America and Europe into mainland China and Southeast Asia.

The decrease in net revenue for 2002 compared to 2001 was primarily the result of the carryover of revenue into 2001 from relatively high orders in 2000. During 2001, the timing difference between orders and revenue became much smaller, resulting in lower carryover of revenue into 2002. Non-recurring royalty revenue relating to changes in our agreement with Adaptec Inc. in 2001 also contributed \$35 million to the decrease in the comparison between 2002 and 2001. The decrease in net revenue for 2001 compared to 2000 was primarily due to the sharp decline in demand for our semiconductor products. The global economic slowdown led to lower volumes in virtually all product lines of the business. Revenue from sales to Hewlett-Packard, consisting primarily of application-specific integrated circuits (“ASICs”) and motion control products, represented approximately 33 percent of the business’ total net revenue for 2002, 31 percent of net revenue for 2001 and 30 percent of net revenue for 2000. No individual new

products had a material impact on results in 2002; we are seeing good customer acceptance of our F-BAR and E-pHEMT wireless products, but those items are not yet showing a material impact on results.

Costs and Expenses

The following table shows the percentage point increase or decrease in our semiconductor products business' costs and expenses as a percentage of its net revenue for 2002, 2001 and 2000.

<u>Increase (decrease) as a % of Net Revenue</u>	<u>2002 over 2001 Ppts Change</u>	<u>2001 over 2000 Ppts Change</u>
Cost of products	(6)	11
Research and development	—	6
Selling, general and administrative	1	3

The decrease in cost of products as a percentage of net revenue in 2002 compared to 2001 despite overall reduced revenue was a direct result of the 2001 Plan; savings from restructuring reduced total cost of products by approximately \$170 million for the year. The increase in cost of products as a percentage of net revenue in 2001 compared to 2000 was due in part to increased inventory charges for excess and obsolete inventory. In addition to increases from inventory charges, lower than anticipated manufacturing volumes contributed to the increase in cost of products as a percentage of net revenue due to the fixed nature of our manufacturing costs, as the product lines in this business are particularly capital intensive. Unfavorable mix and large shipments to single customers carrying deep discounts impacted cost of products as a percentage of net revenue unfavorably. Excluding the impact of increased inventory charges, cost of products as a percentage of net revenue for 2001 increased 6 percentage points compared to 2000.

In 2002 we sold \$18 million of inventory previously written-down compared to inventory charges of \$84 million in 2001 and \$4 million in 2000. The sales of written-off inventory in the current year were due to unanticipated demand for products previously considered to be unmarketable. The bulk of the unanticipated sales in 2002 were made in image/navigation, general fiber optics and hardcopy ASICs. The large increase in inventory charges in 2001 compared to 2000 reflected the dramatic decline of market conditions where this business focuses its sales; the charges affected raw materials used in all of our major products, including image/navigation, telecom fiber optics, general fiber optics, hardcopy ASICs and couplers.

Both research and development expenses and selling, general and administrative expenses were flat for 2002 compared to 2001. The increase in research and development expenses as a percentage of net revenue in 2001 compared to 2000 was driven by a continued commitment to develop new products in the fiber optics, high-speed networking, and image position sensor businesses. The increase in selling, general and administrative expenses as a percentage of net revenue for 2001 compared to 2000 was the result of declining revenue; the total amount of selling, general and administrative expenses were reduced by \$9 million due to the expense containment measures that we implemented in 2001 prior to restructuring.

(Loss) Earnings from Operations

The reduced loss from operations in 2002 compared to 2001 was the result of reduced inventory charges and our cost containment measures, including the 2001 Plan. Overall, we reduced average headcount by 13 percent in 2002, in addition to headcount reductions of 12 percent at the end of 2001 compared to the end of 2000. Overall savings from restructuring in 2002 totaled \$250 million for the full year. For the 2002 Plan, the business expects to further reduce average headcount in 2003 by about 6 percent; the scope of the restructuring covers all categories of cost and expenses and all regions of operations. When complete, the 2002 Plan is

expected to save approximately \$10 million per quarter by the end of the year, and is expected to bring the business back to profitability.

The loss from operations in 2001 compared to earnings from operations in 2000 resulted primarily from lower net revenue and higher cost of products and expenses as a percentage of net revenue due to the fixed nature of our expenses.

Life Sciences and Chemical Analysis

Our life sciences and chemical analysis business provides application-focused solutions that include instruments, software, consumables and services that enable customers to identify, quantify and analyze the physical and biological properties of substances and products. Overall, orders growth over the last 12 quarters has indicated that the markets for our life sciences and chemical analysis products has been slowly but steadily increasing, with some regular seasonality patterns that recur predictably each year. Due to U.S. government and large pharmaceutical budgets, orders in our first and fourth quarters are seasonally greater than those in our second and third quarters. However, general economic trends, new product introductions and competition might overshadow this trend in any given year. In 2002, the primary driver for growth in life sciences products revenue was strong acceptance of new products, with some offsetting declines in the pharmaceuticals market. The primary drivers of revenue growth in chemical analysis for 2002 were U.S. government spending and Asian economic development.

Orders and Net Revenue

	Years Ended October 31,			2002 over 2001 Change	2001 over 2000 Change
	2002	2001	2000		
	(in millions)				
Orders	\$1,151	\$1,103	\$1,053	4%	5%
Net revenue from products	\$ 884	\$ 872	\$ 788	1%	11%
Net revenue from services and other	249	242	252	3%	(4)%
Total net revenue	\$1,133	\$1,114	\$1,040	2%	7%
Earnings from operations	150	91	10	65%	810%
Operating margin	13%	8%	1%	5 points	7 points

The increase in orders in 2002 compared to 2001 was driven by government spending in the U.S. and abroad, growth in new technology areas such as microarrays and Chemchip and the growth of the chemical analysis market. In our life sciences markets, new technologies drove improved orders performance, while our pharmaceuticals customers continued to reduce orders this year. In our chemical analysis markets, U.S. government spending on homeland security and Asian government spending on infrastructure were the primary growth areas. Orders in Asia grew 12 percent this year, primarily for products in the environmental and foods markets. The increase in orders in 2001 compared to 2000 was the result of the overall steady upward market trend in life sciences and chemical analysis products. We expect that recently- and soon-to-be-released new products will continue to produce orders growth in the coming year.

The increase in net revenue for 2002 compared to 2001 was a result of increased sales in both our life sciences products and our chemical analysis products. In life sciences, increased revenue was driven by growth in new technology areas such as microarrays and Chemchip, but overall weakness in pharmaceutical industry spending continues. New products contributed significantly to our performance in 2002; revenue for new products was approximately \$80 to \$90 million for the year, primarily for microarrays and microarray systems, Chemchip applications and systems and new liquid chromatography and liquid chromatography/mass spectrometry applications. The increase in net revenue for 2001 compared to 2000 was the result of increased sales of our products in the life sciences market moderated by decreased sales of our

products in our traditional chemical and petrochemical markets. Net revenue from products including liquid chromatography equipment, bioanalyzers and microarrays grew more than 20 percent in 2001 compared to 2000. Services and other revenue decreased slightly in 2001 compared to 2000, primarily as a result of customers choosing to receive services on a time-and-materials basis rather than renewing long-term service contracts, a common trend in the face of difficult economic times.

Costs and Expenses

The following table shows the percentage point decrease in our life sciences and chemical analysis business' costs and expenses as a percentage of its net revenue for 2002, 2001 and 2000.

<u>Decrease as a % of Net Revenue</u>	<u>2002 over 2001 Ppts Change</u>	<u>2001 over 2000 Ppts Change</u>
Cost of products and services	(3)	(2)
Research and development	—	(1)
Selling, general and administrative	(2)	(5)

Cost of products and services as a percentage of net revenue was down slightly in 2002 compared to 2001. Tight expense management and cost reductions, improved management of inventories and reductions in infrastructure expenses this year drove a \$17 million decrease in total spending. Cost of products and services as a percentage of net revenue was flat in 2001 compared to 2000; additional depreciation expense related to increased spending in manufacturing capacity for microarrays was offset by cost controls and improved operational efficiencies.

Inventory charges totaled \$4 million in 2002 compared to \$11 million in 2001 and \$9 million in 2000. The slightly increased inventory charge run-rate in 2001 compared to both 2000 and 2002 was due to overall inventory reductions in the face of the difficult economy and some consolidation of warehouses to increase efficiency.

The life sciences and chemical analysis business did not participate significantly in the 2001 Plan until the fourth quarter of 2002, when we took steps to consolidate our facilities in California. In order to minimize moving expense and capital investments in existing space, we will outsource components of the manufacturing process. For the 2002 Plan, our restructuring efforts will be focused on improving the manufacturability and quality of our products.

Research and development expenses as a percentage of net revenue were flat for both 2002 compared to 2001 and 2001 compared to 2000. Steady spending on research and development is required to produce new products that can improve revenues and market share in future years. Selling, general and administrative expenses as a percentage of net revenue were flat in 2002 compared to 2001; the decrease in selling, general and administrative expenses as a percentage of net revenue for 2001 compared to 2000 reflected our efforts to reduce cost structures and discretionary expenses.

Earnings from Operations

The increase in earnings from operations in 2002 compared to 2001 was primarily due to increased revenue and continued cost controls. Overall, cost controls, inventory management and infrastructure reductions contributed approximately \$20 million to our bottom line for the year. The increase in earnings from operations in 2001 compared to 2000 was primarily due to higher net revenue and reduced spending resulting from our cost reduction measures. In addition, operational efficiencies arising out of manufacturing centralization efforts begun in fiscal 2000 and increased volumes contributed to the increase.

Healthcare Solutions – Discontinued Operations

Our healthcare solutions business has been classified as a discontinued operation. The table below shows the results of our healthcare solutions business before general overhead allocations and net of the costs of divestiture. Results for the year ended October 31, 2001 include operations from November 1, 2000 to May 31, 2001, the measurement date in accordance with APB No. 30. The net loss from discontinued operations of \$58 million for the two-month period following our May 31, 2001 measurement date was included in the gain from sale of discontinued operations. The after-tax gain resulting from the sale of our healthcare solutions business including this loss was \$646 million.

The following table shows the detailed results of operations of our discontinued healthcare solutions business for 2001 and 2000. These results are also included in our consolidated statement of operations as net earnings from discontinued operations for the years ended 2001 and 2000.

	Years Ended October 31,	
	2001(a)	2000
	(in millions)	
Net revenue	\$765	\$1,412
Costs and expenses	747	1,283
Earnings from discontinued operations	18	129
Other income (expense), net	3	17
Earnings from discontinued operations before taxes	21	146
Provision for taxes	15	61
Net earnings from discontinued operations	<u>\$ 6</u>	<u>\$ 85</u>

(a) Includes operations from November 1, 2000 to May 31, 2001, the measurement date.

Financial Condition

Liquidity and Capital Resources

Our financial position remained strong at October 31, 2002, with cash and cash equivalents of \$1,844 million.

We used cash from continuing operations of \$585 million in 2002 compared to \$114 million used in 2001 and \$536 million generated in 2000. Of the \$585 million cash used in operations in 2002, \$235 million was spent on restructuring activities, primarily in the form of severance payments. Inventory-related charges were significantly lower in 2002 than in the previous year at \$40 million compared to \$459 million a year ago. The abnormally high charges in 2001 compared to 2000 and 2002 were the result of the rapid and steep market decline that year, which caused excess inventory of then-current products and hastened the obsolescence of older products. As demand for our products generally declined in 2002, we have been able to manufacture more products using inventory on hand and have reduced the amounts that we have purchased from suppliers.

An 8 percent increase in revenues in the fourth quarter of 2002 compared to the same quarter in 2001 was the primary cause of a 14 percent increase in accounts receivable at the end of 2002 as compared to the prior year. At the end of fiscal 2001 accounts receivable had decreased by about 50 percent compared to the end of fiscal 2000, primarily due to a 47 percent decline in fiscal 2001 fourth quarter revenues as compared to the fourth quarter of 2000. There were no material bad debt charges in any of the years presented. The net amount of cash used in

the reduction of accounts payable declined from \$480 million in 2001 to \$89 million in 2002. This trend is generally consistent with the decrease in our operating expenses.

In 2002, \$84 million of cash was used to fund our U.S. defined benefit plans and \$105 million was contributed to our international defined benefit plans. This year's contributions were approximately \$128 million or 210 percent larger than in the previous year due primarily to a decline in equity markets globally. Our annual contributions are highly dependent on the relative performance of our assets versus our projected liabilities, among other factors. If the value of our assets declines relative to our future projected obligations, we have to make larger contributions to maintain our funded status. In 2003, we expect to fund our retirement plans in approximately the same amounts as in 2002.

We currently have over \$1 billion of deferred tax assets. The significant increase in deferred tax assets for 2002 is due primarily to net operating loss carry-forwards ("NOLs"), foreign tax credits and research and development tax credits. We expect to utilize the NOLs, foreign tax credits and research and development tax credits to reduce future tax liabilities when we return to profitability.

Our need to control discretionary spending and conserve cash in the face of the weak economy has significantly reduced the amounts we considered to be available for investments such as new company acquisitions, equity investments and property, plant and equipment. Net cash used by investing activities for 2002 was \$71 million compared to \$1,365 million in 2001 and \$1,062 million in 2000. In 2002, we used \$15 million to purchase equity in strategically aligned companies. In 2001 we spent \$904 million, primarily for the acquisition of OSI and for the Yokagawa Purchase. In 2000 we used \$634 million for the first and second installments of the Yokagawa Purchase along with investments in several other companies. In 2001, we used cash of \$289 million for a long-term leasehold investment on which the lessee prepaid \$237 million of rent in 2002. Capital spending controls imposed in the fourth quarter of 2001 reduced spending on property, plant and equipment by \$580 million in 2002 compared to the prior year. In 2002 the majority of property, plant and equipment purchases were related to the implementations of our ERP and CRM systems and to the development of our website. The total program costs for these three initiatives were \$281 million in 2002 compared to \$164 million in 2001. Of these amounts, we capitalized \$148 million in 2002 and \$91 million in 2001 and the remainder was expensed. We estimate that the total program cost in 2003 for these initiatives will be approximately \$160 million. Although these programs used significant resources in 2002 and 2001, when they are completed we will be able to retire over 1000 legacy systems, resulting in significant savings. We had no material dispositions of property, plant and equipment in 2002 compared to \$633 million in 2001 related to the sale of land in San Jose and the CIT Group Sale.

In November 2001, we borrowed \$1,123 million, net of issuance costs, under a private offering of 3 percent senior convertible debentures due in 2021. A registration statement filed on behalf of certain holders of the debentures became effective on April 11, 2002. The debentures are convertible at any time into our common stock at an initial conversion price of \$32.22 per share, subject to adjustment (as defined in the related Indenture agreement dated November 27, 2001) and are redeemable at our option at any time on or after December 6, 2004. Holders of the debentures have the ability to require us to repurchase the debentures, in whole or in part, on specified dates in 2006, 2011 and 2016. Holders also have the right to require us to repurchase all or a portion of the outstanding debentures if we undergo a Fundamental Change (as defined in the Indenture agreement) at a price equal to 100 percent of the principal amount plus interest. The debentures bear interest at an annual rate of 3 percent, payable on June 1 and December 1 of each year beginning June 1, 2002. The interest rate will reset (as defined in the Indenture agreement) in June 2006, June 2011 and June 2016, but in no event will it be reset below 3 percent or above 5 percent per annum. More information regarding the terms of the debentures, including conversion price, Fundamental Change and the interest rate reset can be found in the Indenture agreement.

On August 1, 2001 we completed the sale of our healthcare solutions business to Phillips for initial proceeds of approximately \$1.7 billion. In May of 2002 we finalized the sale agreement. We received \$1.6 billion in August of 2001 and since then we have received all of the \$100 million withheld by Phillips from the total purchase price at the time of the sale plus adjustments for the final purchased net assets. Cash flows from discontinued operations include the proceeds from the sale and cash used in the operations of the healthcare solutions business during the year up until the date of sale.

We have terminated our \$250 million five-year revolving credit facility that was due to expire on November 5, 2005 and have not extended the \$250 million 364-day revolving credit facility that terminated on November 1, 2002. We had no outstanding balances under these credit facilities during 2002. We did not have plans to use these credit facilities, and we believe that the costs of renewing and/or retaining these credit facilities outweighed their benefits. We continue to have access to uncommitted credit lines through our banking partners, although we do not anticipate any significant additional credit needs in the next year.

In the normal course of business, we enter into contractual commitments to purchase materials and components from suppliers in exchange for favorable pricing or more beneficial terms. These regular purchase agreements did not exceed 5 percent of cost of sales. We have contractual commitments to non-cancelable operating leases and vendor financing arrangements with CIT. We provide lease guarantees on these financing arrangements and we have no other material guarantees or commitments. See Note 16, "Other Accrued Liabilities" to the consolidated financial statements for further information on lease guarantees. See Note 18, "Commitments" to the consolidated financial statements for further information on our non-cancelable operating leases.

We are taking actions to achieve positive cash flows from operations in 2003. We will benefit from significant cost savings through our restructuring programs and we have plans to further improve our collection of accounts receivable and lower our inventory levels. Inventory levels already have been reduced by over \$400 million from two years ago. This represents major progress in a key area of our asset performance.

Our liquidity is affected by many factors, some of which are based on normal operating cash flow patterns of our businesses and some of which arise from fluctuations related to global economies and markets. Our cash balances are generated and held in a number of locations throughout the world, and in some cases tax rules and regulations could restrict our ability to move cash balances from one jurisdiction to meet cash requirements in another jurisdiction without incurring tax penalties. We do not currently expect such regulations and restrictions to impact our ability to pay vendors and conduct operations throughout our global organization. We believe that our current cash and cash equivalents and other borrowing capabilities will be sufficient to satisfy our working capital, capital expenditure and other liquidity needs for 2003.

Risks, Uncertainties and Other Factors That May Affect Future Results

Our operating results and financial condition could continue to be harmed if the industries into which we sell our products, such as the communications, electronics and semiconductor industries, remain depressed.

The economic downturn resulted in reduced purchasing and capital spending in many of the markets that we serve worldwide. In particular, the communications, semiconductor and electronics industries have been in a downward cycle characterized by diminished product demand, excess manufacturing capacity and the increasing erosion of average selling prices. Although some segments of these industries have shown recent signs of stabilization, others, especially in communications, continue to exhibit a downward cycle. There has been year-over-year orders growth in our semiconductor products, life sciences and chemical analysis, semiconductor test and wireless test businesses, but demand in these markets remains volatile so

the underlying trend is uncertain. In addition, our businesses serving wireline telecommunications markets have continued to decline. Pricing pressures intensified throughout 2002, reducing our gross margins.

We are uncertain how long the current downturn will last and when a sustained recovery in our markets may occur. Any further decline in our customers' markets or in general economic conditions would likely result in a further reduction in demand for our products and services. In addition, if our customers' markets continue to decline, we may not be able to collect on outstanding amounts due to us. Such further decline could harm our consolidated financial position, results of operations, cash flows and stock price, and could limit our ability to reach our goals for restoring profitability. Also, in such an environment, pricing pressures could continue, and if we are unable to respond quickly enough this could negatively impact our gross margins. Finally, we may be required to secure additional debt or equity financing at some time in the future, and we cannot assure you that such financing will be available on acceptable terms when required.

The actions we took in response to the reduced demand for our products and services could have long-term adverse effects on our business.

Beginning in the third quarter of 2001, our revenue started declining. To scale back our operations and to reduce our expenses in response to this decreased demand for our products and services and lower revenue, we reduced our workforce, froze hiring, cut back significantly on our use of temporary workers and reduced discretionary spending. We also initiated short-term facility closures to reduce production levels.

In calendar year 2001, we announced plans to reduce our workforce by approximately 8,000 people. This reduction was completed at the end of the fourth quarter of 2002. In connection with our announcement of our results for the quarter ended July 31, 2002, we announced that to reach our profitability goals we will have to reduce costs by approximately another \$50 million per quarter. This entails approximately 2,500 additional job cuts, which are underway. In addition, from May 1 to October 31 of 2001, we instituted a 10 percent pay reduction applicable to all employees globally, wherever legally permissible. Starting in the first quarter of 2002, we continued the 10 percent pay reduction for approximately 2,000 of our senior managers. In February of 2002, we reinstated the pay reduction at a rate of 5 percent for our other employees, wherever legally permissible. The reductions in pay took effect via a reduction in hours for certain employees, in accordance with local law. In addition to these measures, we are continuing our initiatives to streamline our operations. The pay reductions continued throughout our third quarter. Starting August 1, 2002, we restored full pay to all employees worldwide, which increases the pressure to reach our profitability goals.

There are several risks inherent in our efforts to transition to a reduced cost structure. These include the risk that we will not be able to reduce expenditures quickly enough and sustain them at a level necessary to restore profitability, and that we may have to undertake further restructuring initiatives that would entail additional charges. For example, prior to the third quarter of 2002, we had not anticipated the necessity for the further restructuring initiatives to reduce costs by another \$50 million per quarter. In addition, there is the risk that cost-cutting initiatives will impair our ability to effectively develop and market products and remain competitive in the industries in which we compete. Each of the above measures could have long-term effects on our business by reducing our pool of technical talent, decreasing or slowing improvements in our products, making it more difficult for us to respond to customers, limiting our ability to increase production quickly if and when the demand for our products increases and limiting our ability to hire and retain key personnel. These circumstances could cause our earnings to be lower than they otherwise might be.

As demand for our products does not match our manufacturing capacity, our earnings may continue to suffer.

Because we cannot immediately adapt our production capacity and related cost structures to rapidly changing market conditions, when demand does not meet our expectations, our manufacturing capacity will likely exceed our production requirements. Currently, we have excess manufacturing capacity as a result of the decrease in purchasing and capital spending in the communications, electronics and semiconductor industries. The fixed costs associated with excess manufacturing capacity have adversely affected, and may continue to adversely affect, our earnings. Conversely, if during a market upturn we cannot increase our manufacturing capacity to meet product demand, we will not be able to fulfill orders in a timely manner, which in turn may have a negative effect on our earnings and overall business.

Failure to adjust our orders for parts and inventories due to changing market conditions could adversely affect our earnings.

Our earnings could be harmed if we are unable to adjust our orders for parts to market fluctuations. In order to secure components for the production of products, we may continue to enter into non-cancelable purchase commitments with vendors, or at times make advance payments to suppliers, which could impact our ability to adjust our inventory to declining market demands. Prior commitments of this type have resulted in an excess of parts as demand for our communications, semiconductor and electronics products has decreased. For example, in the year ended October 31, 2001, we incurred approximately \$459 million of inventory-related charges, and in the twelve months ended October 31, 2002, we have incurred approximately another \$40 million in inventory-related charges. If the demand for our products continues to decrease, we may experience additional excess and obsolete inventories and be forced to incur additional charges. By contrast, during a market upturn, our results could be materially and adversely impacted if we cannot increase our inventories quickly enough to meet increasing demand for our products. Approximately 5 percent of our parts require custom work. Of these, some parts are not readily available from alternate suppliers, due to their unique nature or the length of time necessary for design work. Should a supplier cease manufacture of such a component, we would be forced to reengineer our product. In addition to discontinuing parts, suppliers may also extend lead times, limit supplies or increase prices due to capacity constraints or other factors.

We are continuing to implement new information systems, and problems with the design or implementation of these new systems have interfered and could further interfere with our operations.

We are in the process of implementing new information systems to eventually replace our current systems, which are largely based on legacy systems that were created when we were a part of Hewlett-Packard. As a part of this effort, we are implementing new enterprise resource planning software and other software applications to manage our business operations. We may not be successful in implementing these new systems and transitioning data. In the quarter ended October 31, 2002, following the first phase of our enterprise resource planning software implementation, we were still experiencing some difficulties in providing customer quotes and in acknowledging and shipping customer orders. Although we believe that we have identified, to a large extent, the problems associated with the implementation and that the system is now stabilizing, new problems could arise that we have not foreseen. During 2003, we expect to implement a new customer support information system and some additional functionality to our enterprise resource planning software. If further disruptions occur in the current implementation or the implementation of the additional system and functionality in 2003, our operations could be interrupted. Such disruptions could adversely impact our ability to do the following in a timely manner: provide quotes, take customer orders, ship products, provide services and support to our customers, bill and track our customers, fulfill contractual obligations and otherwise run our

business. As a result, our financial position, results of operations, cash flows and stock price could be adversely affected. In addition, our future revenue and profit projections could be inaccurate if we have misjudged the realization of potential future savings from the new systems.

Fluctuations in our quarterly operating results may cause volatility in the price of our common stock and the senior convertible debentures.

Given the nature of the markets in which we participate, we cannot reliably predict future revenue and profitability. Our quarterly sales and operating results have become highly dependent on the volume and timing of orders received during the quarter, which are difficult to forecast. Throughout 2002, the continued low levels of orders significantly affected our ability to efficiently plan production and inventory levels, which led to fluctuations in operating results. In addition, a significant portion of our operating expenses is relatively fixed in nature due to our significant sales, research and development and manufacturing costs. If we cannot adjust spending quickly enough to compensate for a revenue shortfall, this may magnify the adverse impact of such revenue shortfall on our results of operations. Fluctuations in our operating results may cause volatility in the price of our common stock and the debentures.

If we do not introduce successful new products and services in a timely manner, our products and services will become obsolete, and our operating results will suffer.

We generally sell our products in industries that are characterized by rapid technological changes, frequent new product and service introductions and changing industry standards. Without the timely introduction of new products, services and enhancements, our products and services will become technologically obsolete over time, in which case our revenue and operating results would suffer. The success of our new product and service offerings will depend on several factors, including our ability to:

- properly identify customer needs;
- innovate and develop new technologies, services and applications;
- successfully commercialize new technologies in a timely manner;
- manufacture and deliver our products in sufficient volumes on time;
- differentiate our offerings from our competitors' offerings;
- price our products competitively; and
- anticipate our competitors' development of new products, services or technological innovations.

Economic, political and other risks associated with international sales and operations could adversely affect our results of operations.

Because we sell our products worldwide, our business is subject to risks associated with doing business internationally. We anticipate that revenue from international operations will continue to represent a substantial portion of our total revenue. In addition, many of our manufacturing facilities and suppliers are located outside the U.S. Accordingly, our future results could be harmed by a variety of factors, including:

- interruption to transportation flows for delivery of parts to us and finished goods to our customers;
- changes in foreign currency exchange rates;
- changes in a specific country's or region's political or economic conditions;
- trade protection measures and import or export licensing requirements;

- negative consequences from changes in tax laws;
- difficulty in staffing and managing widespread operations;
- differing labor regulations;
- differing protection of intellectual property; and
- unexpected changes in regulatory requirements.

The current U.S. and international response to terrorism could exacerbate these risks. For example, there may be an increased risk of political unrest in regions such as Southeast Asia, where we have significant manufacturing operations. This could disrupt our ability to manufacture products or import parts as well as cause interruptions and/or delays in our ability to transport products to our customers or parts to other locations to continue the manufacturing and assembly processes. Any such delay or interruption could have an adverse effect on our results of operations.

Our business will suffer if we are not able to retain and hire key personnel.

Our future success depends partly on the continued service of our key research, engineering, sales, marketing, manufacturing, executive and administrative personnel. If we fail to retain and hire a sufficient number of these personnel, we will not be able to maintain or expand our business. Our decision to continue temporary pay cuts in 2002 and to eliminate pay increases for 2002 where legally permissible, along with the scaled-down pay increase program for 2003, may harm our long-term ability to retain and hire key personnel. Although the labor market has changed dramatically within the past two years, and our attrition rate has remained low, there is still intense competition for certain highly technical specialties in geographic areas where we continue to recruit.

Our acquisitions, strategic alliances, joint ventures and divestitures may result in financial results that are different than expected.

In the normal course of business, we frequently engage in discussions with third parties relating to possible acquisitions, strategic alliances, joint ventures and divestitures. As a result of such transactions, our financial results may differ from the investment community's expectations in a given quarter. In addition, acquisitions and strategic alliances may require us to integrate a different company culture, management team and business infrastructure. We may have difficulty developing, manufacturing and marketing the products of a newly-acquired company in a way that enhances the performance of our combined businesses or product lines to realize the value from expected synergies. Depending on the size and complexity of an acquisition, our successful integration of the entity depends on a variety of factors, including:

- the retention of key employees;
- the management of facilities and employees in different geographic areas;
- the retention of key customers; and
- the integration or coordination of different research and development, product manufacturing and sales programs and facilities.

A successful divestiture depends on various factors, including our ability to:

- effectively transfer liabilities, contracts, facilities and employees to the purchaser;
- identify and separate the intellectual property to be divested from the intellectual property that we wish to keep; and
- reduce fixed costs previously associated with the divested assets or business.

Any additional impairment of the value of purchased assets and goodwill could have a significant negative impact on our future operating results.

In addition, if customers of the divested business do not receive the same level of service from the new owners, this may adversely affect our other businesses to the extent that these customers also purchase other Agilent products. All of these efforts require varying levels of management resources, which may divert our attention from other business operations. Further, if market conditions or other factors lead us to change our strategic direction, we may not realize the expected value from such transactions. If we do not realize the expected benefits or synergies of such transactions, our consolidated financial position, results of operations, cash flows and stock price could be negatively impacted.

If sales of custom integrated circuits to Hewlett-Packard decline, our semiconductor products revenue will suffer, and we are limited in our ability to sell these integrated circuits to other companies.

Historically, our semiconductor products business has sold custom products to Hewlett-Packard and has engaged in product development efforts with divisions of Hewlett-Packard. For the twelve months ended October 31, 2002, shipments from our semiconductor products group to Hewlett-Packard accounted for approximately 8 percent of our total shipments and approximately 33 percent of our semiconductor products business' shipments.

We have a license agreement with Hewlett-Packard that covers integrated circuit technology used in custom integrated circuits for Hewlett-Packard's printers, scanners and computers. The license agreement provides that, until November 2002 in some cases and until November 2009 in other cases, we are prohibited, with some exceptions, from using this integrated circuit technology for the development and sale of integrated circuits for use in inkjet products, printer products (including printer supplies, accessories and components), document scanners and computing products to third parties other than Hewlett-Packard.

Although we have entered into a supply agreement for the sale to Hewlett-Packard of custom integrated circuits used in printers, scanners and computers, the agreement does not require Hewlett-Packard to purchase a minimum amount of product from us. In the event that Hewlett-Packard reduces its purchases of our custom integrated circuits, we would be unable to address this reduction through sales of these kinds of integrated circuits for these types of products to other customers.

Environmental contamination from past operations could subject us to unreimbursed costs and could harm on-site operations and the future use and value of the properties involved and environmental contamination caused by ongoing operations could subject us to substantial liabilities in the future.

Some of our properties are undergoing remediation by Hewlett-Packard for subsurface contaminations that were known at the time of our separation from Hewlett-Packard. Hewlett-Packard has agreed to retain the liability for this subsurface contamination, perform the required remediation and indemnify us with respect to claims arising out of that contamination. The determination of the existence and cost of any additional contamination caused by us could involve costly and time-consuming negotiations and litigation. In addition, Hewlett-Packard will have access to our properties to perform remediation. While Hewlett-Packard has agreed to minimize interference with on-site operations at those properties, remediation activities and subsurface contamination may require us to incur unreimbursed costs and could harm on-site operations and the future use and value of the properties. We cannot be sure that Hewlett-Packard will continue to fulfill its indemnification or remediation obligations.

We have agreed to indemnify Hewlett-Packard for any liability associated with contamination from past operations at all other properties transferred from Hewlett-Packard to us other than

those properties currently undergoing remediation by Hewlett-Packard. While we are not aware of any material liabilities associated with any potential subsurface contamination at any of those properties, subsurface contamination may exist, and we may be exposed to material liability as a result of the existence of that contamination.

Our semiconductor and other manufacturing processes involve the use of substances regulated under various international, federal, state and local laws governing the environment. We may be subject to liabilities for environmental contamination, and these liabilities may be substantial. Although our policy is to apply strict standards for environmental protection at our sites inside and outside the U.S., even if the sites outside the U.S. are not subject to regulations imposed by foreign governments, we may not be aware of all conditions that could subject us to liability.

Our customers and we are subject to various governmental regulations, compliance with which may cause us to incur significant expenses, and if we fail to maintain satisfactory compliance with certain regulations, we may be forced to recall products and cease their manufacture and distribution, and we could be subject to civil or criminal penalties.

Our businesses are subject to various significant international, federal, state and local regulations, including but not limited to health and safety, packaging, product content, labor and import/export regulations. These regulations are complex, change frequently and have tended to become more stringent over time. We may be required to incur significant expenses to comply with these regulations or to remedy violations of these regulations. Any failure by us to comply with applicable government regulations could also result in cessation of our operations or portions of our operations, product recalls or impositions of fines and restrictions on our ability to carry on or expand our operations. In addition, because many of our products are regulated or sold into regulated industries, we must comply with additional regulations in marketing our products.

Our products and operations are also often subject to the rules of industrial standards bodies, like the International Standards Organization, as well as regulation of other agencies such as the U.S. Federal Communications Commission. We also must comply with work safety rules. If we fail to adequately address any of these regulations, our businesses could be harmed.

Some of our chemical analysis products are used in conjunction with chemicals whose manufacture, processing, distribution and notification requirements are regulated by the U.S. Environmental Protection Agency under the Toxic Substances Control Act, and by regulatory bodies in other countries with laws similar to the Toxic Substances Control Act. We must conform the manufacture, processing, distribution of and notification about these chemicals to these laws and adapt to regulatory requirements in all countries as these requirements change. If we fail to comply with these requirements in the manufacture or distribution of our products, then we could be made to pay civil penalties, face criminal prosecution and, in some cases, be prohibited from distributing our products in commerce until the products or component substances are brought into compliance.

We are subject to laws and regulations governing government contracts, and our failure to address these laws and regulations or comply with government contracts could harm our business by leading to a reduction in revenue associated with these customers.

We have agreements relating to the sale of our products to government entities and, as a result, we are subject to various statutes and regulations that apply to companies doing business with the government. Our sales to U.S. government agencies and contractors are approximately 5 percent of our total sales. The laws governing government contracts differ from the laws governing private contracts. For example, many government contracts contain pricing terms and conditions that are not applicable to private contracts. We are also subject to investigation for

compliance with the regulations governing government contracts. A failure to comply with these regulations might result in suspension of these contracts, or administrative penalties.

Third parties may claim that we are infringing their intellectual property, and we could suffer significant litigation or licensing expenses or be prevented from selling products.

While we do not believe that any of our products infringe the valid intellectual property rights of third parties, we may be unaware of intellectual property rights of others that may cover some of our technology, products or services. Any litigation regarding patents or other intellectual property could be costly and time-consuming and could divert our management and key personnel from our business operations. The complexity of the technology involved and the uncertainty of intellectual property litigation increase these risks. Claims of intellectual property infringement might also require us to enter into costly license agreements. However, we may not be able to obtain license agreements on terms acceptable to us, or at all. We also may be subject to significant damages or injunctions against development and sale of certain of our products.

We often rely on licenses of intellectual property useful for our businesses. We cannot ensure that these licenses will be available in the future on favorable terms or at all. In addition, our position with respect to the negotiation of licenses has changed as a result of our separation from Hewlett-Packard. In the past, as a part of Hewlett-Packard, we benefited from our access to Hewlett-Packard's entire intellectual property portfolio when asserting counterclaims and negotiating cross-licenses with third parties. Our current patent cross-license agreement with Hewlett-Packard gives us only a limited right to sublicense a portion of Hewlett-Packard's intellectual property portfolio. Accordingly, we may be unable to obtain agreements on terms as favorable as we may have been able to obtain if we could have sublicensed Hewlett-Packard's entire intellectual property portfolio. Nothing restricts Hewlett-Packard from competing with us other than some restrictions on the use of patents licensed to Hewlett-Packard by us.

Third parties may infringe our intellectual property, and we may expend significant resources enforcing our rights or suffer competitive injury.

Our success depends in large part on our proprietary technology. We rely on a combination of patents, copyrights, trademarks, trade secrets, confidentiality provisions and licensing arrangements to establish and protect our proprietary rights. If we fail to successfully enforce our intellectual property rights, our competitive position could suffer, which could harm our operating results.

Our pending patent and trademark registration applications may not be allowed, or competitors may challenge the validity or scope of our patents or trademark registrations. In addition, our patents may not provide us a significant competitive advantage.

We may be required to spend significant resources to monitor and police our intellectual property rights. We may not be able to detect infringement and our competitive position may be harmed before we do so. In addition, competitors may design around our technology or develop competing technologies. Intellectual property rights may also be unavailable or limited in some foreign countries, which could make it easier for competitors to capture market share. Furthermore, some intellectual property rights are licensed to other companies, allowing them to compete with us using that intellectual property.

If we suffer loss to our factories, facilities or distribution system due to catastrophe, our operations could be seriously harmed.

Our factories, facilities and distribution system are subject to catastrophic loss due to fire, flood, terrorism or other natural or man-made disasters. In particular, several of our facilities could be subject to a catastrophic loss caused by earthquake due to their locations. Our production facilities, headquarters and Agilent Technologies Laboratories in California, and our

production facilities in Washington and Japan, are all located in areas with above average seismic activity. If any of these facilities were to experience a catastrophic loss, it could disrupt our operations, delay production, shipments and revenue and result in large expenses to repair or replace the facility. Although we carry insurance for property damage and business interruption, we do not carry insurance or financial reserves for interruptions or potential losses arising from earthquakes or terrorism.

If we are required to account for options under our employee stock plans as a compensation expense, our net income and earnings per share would be significantly reduced.

There has been an increasing public debate about the proper accounting treatment for employee stock options. Currently we record compensation expense only in connection with option grants that have an exercise price below fair market value. For option grants that have an exercise price at or in excess of fair market value we calculate compensation expense and disclose the impact on net (loss) earnings and net (loss) earnings per share in a footnote to the consolidated financial statements. It is possible that future laws and regulations will require us to record the fair market value of all stock options as compensation expense in our consolidated statement of operations. Note 14, "Stock-Based Compensation," of the consolidated financial statements reflects the impact that such a change in accounting treatment would have had on our net (loss) income and (loss) earnings per share if it had been in effect during the past three years.

If our operating results do not improve in the long-term we may be required to establish a valuation allowance against our net deferred tax assets.

We evaluate whether our deferred tax assets can be realized and assess the need for a valuation allowance on an ongoing basis. Realization of our net deferred tax assets is dependent on our ability to generate future taxable income. A valuation allowance would be recorded if it were more likely than not that some or all of our deferred tax assets would not be realized before they expire. If we establish a valuation allowance we might record a tax expense in our statement of operations which would have an adverse impact on our net income.

STATEMENT OF MANAGEMENT RESPONSIBILITY

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

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 audits throughout the company. We select and train qualified people who are provided with and expected to adhere to Agilent Technologies' standards of business conduct. These standards, which set forth strong principles of business ethics and conduct, are a key element of our control system.

Our consolidated financial statements have been audited by PricewaterhouseCoopers LLP, independent accountants. Their audits were conducted in accordance with auditing standards generally accepted in the U.S., and included a review of financial controls and tests of accounting records and procedures as they considered necessary in the circumstances.

The Audit and Finance Committee of the Board of Directors, which consists of 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 the internal auditors and the independent accountants.

Edward W. Barnholt
*Chairman of the Board of Directors, President
and Chief Executive Officer*

Adrian T. Dillon
*Executive Vice President and
Chief Financial Officer*

REPORT OF INDEPENDENT ACCOUNTANTS

To the Stockholders and Board of Directors of Agilent Technologies, Inc.:

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of operations, cash flows and stockholders' equity present fairly, in all material respects, the financial position of Agilent Technologies, Inc. and its subsidiaries at October 31, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended October 31, 2002, in conformity with accounting principles generally accepted in the United States of America. 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 auditing standards generally accepted in the United States of America, 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 our opinion.

As discussed in the notes to the consolidated financial statements, the company adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" and changed its method of revenue recognition as of November 1, 2000.

/s/ PRICEWATERHOUSECOOPERS LLP

PricewaterhouseCoopers LLP

San Jose, California
November 18, 2002

AGILENT TECHNOLOGIES, INC.
CONSOLIDATED STATEMENT OF OPERATIONS

	<u>Years Ended October 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
	(in millions, except per share amounts)		
Net revenue:			
Products	\$ 5,234	\$7,485	\$8,300
Services and other	776	911	1,061
Total net revenue	6,010	8,396	9,361
Costs and expenses:			
Cost of products	3,244	4,432	4,046
Cost of services and other	450	458	540
Total costs	3,694	4,890	4,586
Research and development	1,169	1,280	1,065
Selling, general and administrative	2,754	3,004	2,786
Total costs and expenses	7,617	9,174	8,437
(Loss) earnings from operations	(1,607)	(778)	924
Other income (expense), net	60	301	94
(Loss) earnings from continuing operations before taxes	(1,547)	(477)	1,018
(Benefit) provision for taxes	(525)	(71)	346
(Loss) earnings from continuing operations	(1,022)	(406)	672
Earnings from discontinued operations (net of taxes of \$15 million and \$61 million in 2001 and 2000, respectively)	—	6	85
(Loss) gain from sale of discontinued operations (net of tax benefit of \$6 million and expense of \$422 million in 2002 and 2001, respectively)	(10)	646	—
(Loss) earnings before cumulative effect of accounting changes	(1,032)	246	757
Cumulative effect of adopting SFAS No. 133 (net of tax benefit of \$16 million) ...	—	(25)	—
Cumulative effect of adopting SAB 101 (net of tax benefit of \$27 million)	—	(47)	—
Net (loss) earnings	<u>\$(1,032)</u>	<u>\$ 174</u>	<u>\$ 757</u>
Net (loss) earnings per share – Basic:			
(Loss) earnings from continuing operations	\$ (2.20)	\$ (0.89)	\$ 1.49
Earnings from discontinued operations, net	—	0.01	0.19
(Loss) gain from sale of discontinued operations, net	(0.02)	1.41	—
Cumulative effect of adopting SFAS No. 133, net	—	(0.05)	—
Cumulative effect of adopting SAB 101, net	—	(0.10)	—
Net (loss) earnings	<u>\$ (2.22)</u>	<u>\$ 0.38</u>	<u>\$ 1.68</u>
Net (loss) earnings per share – Diluted:			
(Loss) earnings from continuing operations	\$ (2.20)	\$ (0.89)	\$ 1.48
Earnings from discontinued operations, net	—	0.01	0.18
(Loss) gain from sale of discontinued operations, net	(0.02)	1.41	—
Cumulative effect of adopting SFAS No. 133, net	—	(0.05)	—
Cumulative effect of adopting SAB 101, net	—	(0.10)	—
Net (loss) earnings	<u>\$ (2.22)</u>	<u>\$ 0.38</u>	<u>\$ 1.66</u>
Weighted average shares used in computing net (loss) earnings per share:			
Basic	465	458	449
Diluted	465	458	455

Annual
Report
Financials

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

AGILENT TECHNOLOGIES, INC.
CONSOLIDATED BALANCE SHEET

	October 31,	
	2002	2001
	(in millions, except par value and share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$1,844	\$1,170
Accounts receivable, net	1,118	977
Inventory	1,184	1,491
Net investment in lease receivable	1	237
Current deferred tax assets	462	494
Other current assets	271	430
Total current assets	4,880	4,799
Property, plant and equipment, net	1,579	1,848
Goodwill and other intangible assets, net	685	1,070
Long-term deferred tax assets	635	10
Other assets	424	259
Total assets	\$8,203	\$7,986
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 305	\$ 392
Employee compensation and benefits	733	576
Deferred revenue	244	279
Income and other taxes payable	325	173
Other accrued liabilities	574	582
Total current liabilities	2,181	2,002
Senior convertible debentures	1,150	—
Other liabilities	245	325
Total liabilities	3,576	2,327
Commitments and contingencies	—	—
Stockholders' equity:		
Preferred stock; \$0.01 par value; 125 million shares authorized; none issued and outstanding	—	—
Common stock; \$0.01 par value; 2 billion shares authorized; 467 million shares at October 31, 2002 and 461 million shares at October 31, 2001 issued and outstanding	5	5
Additional paid-in capital	4,872	4,723
Retained (deficit) earnings	(101)	931
Accumulated comprehensive loss	(149)	—
Total stockholders' equity	4,627	5,659
Total liabilities and stockholders' equity	\$8,203	\$7,986

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

AGILENT TECHNOLOGIES, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS

	<u>Years Ended October 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
	(in millions)		
Cash flows from operating activities:			
(Loss) earnings from continuing operations	\$(1,022)	\$ (478)	\$ 672
Adjustments to reconcile (loss) earnings from continuing operations to net cash (used in) provided by operating activities:			
Depreciation and amortization	735	734	460
Inventory-related charges	40	459	70
Deferred taxes	(664)	(94)	(59)
Non-cash restructuring and asset impairment charges	204	161	8
Retirement plans curtailment gain	(19)	—	—
Net gain on divestitures and sale of assets	(18)	(447)	(152)
Adoption of SFAS No. 133	—	41	—
Changes in assets and liabilities:			
Accounts receivable	(139)	933	(697)
Inventory	278	(373)	(431)
Accounts payable	(89)	(480)	356
Employee compensation and benefits	89	(145)	149
Income taxes	137	(472)	235
Other current assets and liabilities	16	(8)	4
Other long-term assets and liabilities	(133)	55	(79)
Net cash (used in) provided by operating activities	(585)	(114)	536
Cash flows from investing activities:			
Investments in property, plant and equipment	(301)	(881)	(803)
Dispositions of property, plant and equipment	—	633	333
Proceeds from (net investment in) lease receivable	237	(289)	—
Sale of equity investments	—	74	60
Purchase of equity investments	(23)	(27)	(32)
Acquisitions, net of cash acquired	(15)	(904)	(634)
Proceeds from dispositions	31	13	—
Other, net	—	16	14
Net cash used in investing activities	(71)	(1,365)	(1,062)
Cash flows from financing activities:			
IPO proceeds	—	—	2,068
IPO proceeds transferred to Hewlett-Packard	—	—	(2,068)
Issuance of senior convertible debentures, net of issuance costs	1,123	—	—
Issuance of common stock under employee stock plans	121	150	84
Net (payments to) proceeds from notes payable and short-term borrowings	(1)	(113)	110
Financing from Hewlett-Packard	—	—	1,081
Net cash provided by financing activities	1,243	37	1,275
Net proceeds and cash provided by discontinued operations	87	1,616	247
Change in cash and cash equivalents	674	174	996
Cash and cash equivalents at beginning of year	1,170	996	—
Cash and cash equivalents at end of year	<u>\$ 1,844</u>	<u>\$ 1,170</u>	<u>\$ 996</u>

Annual
Report
Financials

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

AGILENT TECHNOLOGIES, INC.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	<u>Number of Shares</u>	<u>Common Stock</u>		<u>Retained (Deficit) Earnings</u>	<u>Accumulated Comprehensive Loss</u>	<u>Total</u>
		<u>Par Value</u>	<u>Additional Paid-in Capital</u>			
		(in millions, except number of shares in thousands)				
Balance as of October 31, 1999 . . .	380,000	\$ 4	\$ 3,378	\$ —	\$ —	\$ 3,382
Components of comprehensive income:						
Net earnings	—	—	—	757	—	757
Unrealized loss on investment (net of tax benefit of \$3 million)	—	—	—	—	(5)	<u>(5)</u>
Total comprehensive income						<u>752</u>
Shares issued in the IPO	72,000	1	2,067	—	—	2,068
Proceeds from IPO transferred to Hewlett-Packard	—	(1)	(2,067)	—	—	(2,068)
Shares issued for employee benefit plans and other	1,976	1	125	—	—	126
Cash funding from Hewlett- Packard	—	—	1,858	—	—	1,858
Transfer of net assets to Hewlett- Packard	<u>—</u>	<u>—</u>	<u>(853)</u>	<u>—</u>	<u>—</u>	<u>(853)</u>
Balance as of October 31, 2000 . . .	453,976	5	4,508	757	(5)	5,265
Components of comprehensive income:						
Net earnings	—	—	—	174	—	174
Reclassification adjustment relating to warrants (net of tax expense of \$12 million) . . .	—	—	—	—	22	22
Reclassification adjustment relating to derivatives (net of tax expense of \$3 million)	—	—	—	—	(6)	(6)
SFAS No. 133 cumulative transition adjustment	—	—	—	—	6	6
Change in unrealized loss on investment (net of tax benefit of \$13 million)	—	—	—	—	(24)	(24)
Unrealized gain on derivatives (net of tax expense of \$4 million)	—	—	—	—	7	<u>7</u>
Total comprehensive income						<u>179</u>
Shares issued for employee benefit plans and other	5,594	—	150	—	—	150
Issuance of common shares and options for Acquisitions	1,461	—	70	—	—	70
Other additional paid in capital . . .	<u>—</u>	<u>—</u>	<u>(5)</u>	<u>—</u>	<u>—</u>	<u>(5)</u>
Balance as of October 31, 2001 . . .	461,031	5	4,723	931	—	5,659

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

	Number of Shares	Common Stock		Retained (Deficit) Earnings	Accumulated Comprehensive Loss	Total
		Par Value	Additional Paid-in Capital			
(in millions, except number of shares in thousands)						
Components of comprehensive loss:						
Net loss	—	—	—	(1,032)	—	(1,032)
Reclassification adjustment relating to derivatives (net of tax expense of \$4 million)	—	—	—	—	(7)	(7)
SFAS No. 133 cumulative transition adjustment	—	—	—	—	(6)	(6)
Foreign currency translation	—	—	—	—	7	7
Change in unrealized gain on investment (net of tax expense of \$1 million)	—	—	—	—	(1)	(1)
Unrealized gain on derivatives (net of tax expense of \$2 million)	—	—	—	—	4	4
Minimum pension liability adjustment	—	—	—	—	(146)	(146)
Total comprehensive loss						(1,181)
Shares issued for employee benefit plans and other	5,993	—	145	—	—	145
Other additional paid in capital			4			4
Balance as of October 31, 2002	<u>467,024</u>	<u>\$ 5</u>	<u>\$ 4,872</u>	<u>\$ (101)</u>	<u>\$(149)</u>	<u>\$ 4,627</u>

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

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Overview and Basis of Presentation

Agilent Technologies, Inc. (“we,” “Agilent” or the “Company”), incorporated in Delaware in May 1999, is a global diversified technology organization that provides enabling solutions to technology markets within the communications, electronics, life sciences and chemical analysis industries. Prior to our initial public offering of 16 percent of our stock in November 1999, we were a wholly-owned subsidiary of Hewlett-Packard Company (“Hewlett-Packard”). Hewlett-Packard distributed the remaining 84 percent of our stock to its stockholders on June 2, 2000 in the form of a stock dividend.

On August 1, 2001 we completed the sale of our healthcare solutions business to Koninklijke Philips Electronics, N.V. The results of the healthcare solutions business are presented as discontinued operations for all periods in the consolidated financial statements included herein. See Note 4, “Discontinued Operations”.

Our fiscal year end is October 31. Unless otherwise stated, all years and dates refer to our fiscal year.

2. Summary of Significant Accounting Policies

Basis of presentation. The accompanying financial data has been prepared by us pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (“SEC”). Amounts in the consolidated financial statements as of and for the years ended October 31, 2001 and October 31, 2000 have been reclassified to conform to the presentation in 2002.

Principles of consolidation. The consolidated financial statements include the accounts of the company and our wholly- and majority-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Use of estimates. The preparation of financial statements in accordance with accounting principles generally accepted in the U.S. requires that management make a number of estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses in our consolidated financial statements and accompanying notes. Management bases its estimates on historical experience and various other assumptions believed to be reasonable. Although these estimates are based on management’s best knowledge of current events and actions that may impact the Company in the future, actual results may be different from the estimates.

Revenue recognition. Revenue from product sales, net of trade discounts and allowances, is recognized once delivery has occurred provided that persuasive evidence of an arrangement exists, the price is fixed or determinable, and collectibility is reasonably assured. Delivery is considered to have occurred when title and risk of loss have transferred to the customer. Revenue is reduced for estimated product returns and distributor price protection, when appropriate. For sales that include customer-specified acceptance criteria, revenue is recognized after the acceptance criteria have been met. For products that include installation, if the installation meets the criteria to be considered a separate element, product revenue is recognized upon delivery, and recognition of installation revenue is delayed until the installation is complete. Otherwise, neither the product nor the installation revenue is recognized until the installation is complete. Provisions are established for estimated costs that may be incurred for product warranties. Revenue from services is recognized over the contractual period or as services are rendered and accepted by the customer.

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Shipping and handling costs. Our shipping and handling costs charged to customers are included in net revenue and the associated expense is recorded in total costs for all periods presented.

Deferred revenue. Deferred revenue is primarily made up of service, support and maintenance agreements, and advanced billings and customer deposits.

Goodwill and purchased intangible assets. Goodwill and purchased intangible assets are carried at cost less accumulated amortization. Amortization is computed using the straight-line method over the economic lives of the respective assets, generally three to ten years. Goodwill resulting from acquisitions completed after June 30, 2001 has not been amortized, in accordance with the requirements of Statement of Financial Accounting Standards (“SFAS”) No. 142, “Goodwill and Other Intangible Assets” (“SFAS No. 142”).

Advertising. Advertising costs are expensed as incurred and amounted to \$81 million in 2002, \$115 million in 2001 and \$178 million in 2000.

Taxes on earnings. Income tax expense or benefit is based on earnings or loss before taxes. Deferred tax assets and liabilities are recognized principally for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts. Prior to June 3, 2000, our operating results were included in Hewlett-Packard’s consolidated U.S. and state income tax returns and in tax returns of certain Hewlett-Packard foreign subsidiaries.

Net (loss) earnings per share. Basic net (loss) earnings per share is computed by dividing net (loss) earnings – the numerator – by the weighted average number of common shares outstanding – the denominator – during the period excluding the dilutive effect of stock options and other employee stock plans. Diluted net (loss) earnings per share gives effect to all potentially dilutive common stock equivalents outstanding during the period. In computing diluted net (loss) earnings per share, the average stock price for the period is used in determining the number of shares assumed to be purchased from the proceeds of stock option exercises. Diluted net (loss) earnings per share for 2002 and 2001 excludes the potentially dilutive effect of common stock equivalents as their effect is antidilutive.

Cash and cash equivalents. We classify investments as cash equivalents if their original maturity is three months or less. Cash equivalents are stated at cost, which approximates fair value.

Fair value of financial instruments. The carrying values of certain of our company’s financial instruments, including cash and cash equivalents, accrued compensation and other accrued liabilities approximate fair value because of their short maturities. The fair values of investments are determined using quoted market prices for those securities or similar financial instruments.

Concentration of credit risk. We sell the majority of our products through our direct sales force. No single customer accounted for 10 percent or more of the combined accounts receivable balance at October 31, 2002 and 2001. Credit risk with respect to accounts receivable is generally diversified due to the large number of entities comprising our customer base and their dispersion across many different industries and geographies. We perform ongoing credit evaluations of our customers’ financial conditions, and require collateral, such as letters of credit and bank guarantees, in certain circumstances.

Derivative instruments. We enter into foreign exchange contracts, primarily forward contracts and purchased options, to hedge exposures to changes in foreign currency exchange

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

rates. These contracts are designated at inception as hedges of the related foreign currency exposures, which include committed and anticipated intercompany transactions and assets and liabilities that are denominated in currencies other than functional currency. To achieve hedge accounting, contracts must reduce the foreign currency exchange rate risk otherwise inherent in the amount and duration of the hedged exposures and comply with established risk management policies; hedging contracts generally mature within twelve months. We do not use derivative financial instruments for speculative or trading purposes.

When hedging anticipated intercompany cash flow exposure, foreign exchange contract expirations are set so as to occur in the same period that the goods are expected to be sold to third parties, allowing realized gains and losses on the contracts to be recognized into cost of goods sold. When hedging balance sheet exposure, gains and losses on foreign exchange contracts are recognized in other income (expense), net in the same period as the occurrence of gains and losses on remeasurement of the non-functional currency denominated assets and liabilities. The gains and losses, which have not been material, are included in cash flows from operating activities in the consolidated statement of cash flows.

We may also, from time to time, acquire warrants to purchase securities of other companies as part of strategic relationships.

Inventory. Inventory is valued at standard cost which approximates actual cost computed on a first-in, first-out basis, not in excess of market value.

Property, plant and equipment. Property, plant and equipment are stated at cost less accumulated depreciation. Additions, improvements and major renewals are capitalized; maintenance, repairs and minor renewals are expensed as incurred. When assets are retired or disposed of, the assets and related accumulated depreciation and amortization are removed from our general ledger and the resulting gain or loss is reflected in operations. Buildings and improvements are depreciated over fifteen to forty years and machinery and equipment over three to ten years. The straight-line method of depreciation was adopted for all property, plant and equipment placed into service after November 1, 2001. The effect of this change on the net loss for the year was insignificant. For property, plant and equipment placed into service prior to November 1, 2001, depreciation is provided using accelerated methods, principally over fifteen to forty years for buildings and improvements and three to ten years for machinery and equipment, including equipment leased to customers under operating leases. Depreciation of leasehold improvements is provided using the straight-line method over the life of the asset or the term of the lease, whichever is shorter.

Capitalized software. We capitalize certain internal and external costs incurred to acquire or create internal use software in accordance with AICPA Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." Capitalized software is included in property, plant and equipment under machinery and equipment and is amortized over its useful life when development is complete.

Impairment of long-lived assets. We continually monitor events and changes in circumstances that could indicate carrying amounts of long-lived assets, including intangible assets, may not be recoverable. When such events or changes in circumstances occur, we assess the recoverability of long-lived assets by determining whether the carrying value of such assets will be recovered through undiscounted expected future cash flows. If the total of the future cash flows is less than the carrying amount of those assets, we recognize an impairment loss based on the excess of the carrying amount over the fair value of the assets. See Note 3, "New Accounting Pronouncements" for further discussion.

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Foreign currency translation. Effective November 1, 2001, we have determined that the functional currency for many of our subsidiaries outside the U.S. has changed from the U.S. dollar to local currency based on the criteria of SFAS No. 52 “Foreign Currency Translation”. This change did not have a material impact on our consolidated financial position as of November 1, 2001. For those subsidiaries that operate in a local currency functional environment, all assets and liabilities are translated into U.S. dollars using current exchange rates; revenue and expenses are translated using average exchange rates in effect during each period. Resulting translation adjustments are reported as a separate component of accumulated comprehensive loss in stockholders’ equity.

For those subsidiaries that operate in a U.S. dollar functional environment, foreign currency assets and liabilities are remeasured into U.S. dollars at current exchange rates except for inventory, property, plant and equipment, other assets and deferred revenue, which are remeasured at historical exchange rates. Revenue and expenses are generally translated at average exchange rates in effect during each period, except for those expenses related to balance sheet amounts that are remeasured at historical exchange rates. Gains or losses from foreign currency remeasurement are included in consolidated net (loss) earnings.

For our subsidiaries which are local currency functional, the effect of foreign currency exchange rate fluctuations during 2002 on our consolidated cash and cash equivalents balance was not material.

3. New Accounting Pronouncements

In July 2001, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 142 under which goodwill will no longer be amortized but reviewed annually (or more frequently if impairment indicators arise) for impairment. We adopted SFAS No. 142 on November 1, 2002. Subsequently, we are required to evaluate our existing goodwill and intangible assets and make any necessary reclassification in order to comply with the new criteria in SFAS No. 142. Based on our assessment, effective in the first quarter of 2003, approximately \$6 million of intangible assets associated with workforce-in-place will be reclassified to goodwill.

As part of our assessment, we used the fair value measurement requirement, rather than the previously required undiscounted cash flows approach, and as a result we expect to record a transitional impairment loss from the implementation of SFAS No. 142 as a change in accounting principle in the first quarter of 2003. The fair value of the reporting units was determined primarily by the income approach, which estimates the fair value based on the future discounted cash flows. The first step evaluation of reporting units on a fair value basis, as required by SFAS No. 142, indicated that an impairment exists in the communications solutions reporting unit within our test and measurement business. The revenue forecasts of the communications solutions reporting unit have been impacted by the prolonged economic downturn in the communications test markets. We were required to perform the second step analysis to determine the amount of the impairment loss for the reporting unit that failed the first step test. The second step analysis consisted of comparing the implied fair value of the reporting unit’s goodwill with the carrying amount of the reporting unit’s goodwill, with an impairment charge resulting from any excess of the carrying value of the reporting unit’s goodwill over the implied fair value of the reporting unit’s goodwill. Based upon this evaluation, the pre-tax impairment is expected to be \$268 million, approximately 44 percent of total consolidated goodwill recorded as of October 31, 2002. The adoption of SFAS No. 142 is also expected to have a material impact on our results of operations because goodwill will no longer be amortized subsequent to the adoption of SFAS

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

No. 142. Amortization of goodwill was \$326 million in 2002, \$303 million in 2001 and \$64 million in 2000.

In August 2001, the FASB issued SFAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets (“SFAS No. 144”). SFAS No. 144 amends existing accounting guidance on asset impairment and provides a single accounting model for long-lived assets to be disposed of. Among other provisions, the new rules change the criteria for classifying an asset as held-for-sale. The standard also broadens the scope of businesses to be disposed of that qualify for reporting as discontinued operations, and changes the timing of recognizing losses on such operations. We will adopt SFAS No. 144 in the first quarter of 2003. We do not believe that the adoption will have a material impact on our consolidated financial position, results of operations or cash flows.

In July 2002, the FASB issued SFAS No. 146, which nullifies EITF No. 94-3. SFAS No. 146 requires that a liability be recognized for restructuring costs only when the liability is incurred, that is, when it meets the definition of a liability in the FASB’s conceptual framework. SFAS No. 146 also establishes fair value as the objective for initial measurement of liabilities related to exit or disposal activities and is effective for exit or disposal activities that are initiated after December 31, 2002, with earlier adoption encouraged. The effect of adoption is dependent on the timing of our related restructuring activities; however, we do not believe that the adoption of SFAS No. 146 will have a material impact on our consolidated financial position, results of operations, or cash flows.

4. Discontinued Operations

On August 1, 2001, we completed the sale of our healthcare solutions business to Koninklijke Philips Electronics, N.V. (“Philips”) pursuant to an Asset Purchase Agreement for a total purchase price of \$1.7 billion. Philips paid initial proceeds of \$1.6 billion to us on August 1, 2001, with further payments following pursuant to the terms of the Asset Purchase Agreement dated as of November 17, 2000, as amended and supplemented by the Amendment and Supplemental Agreement, dated as of August 1, 2001 (collectively, the “Asset Purchase Agreement”). The total purchase price was subject to adjustment based on the determination of the final purchased net assets and on our performance of integration services for Philips.

Our consolidated financial statements reflect our healthcare solutions business as discontinued operations in accordance with Accounting Principles Board (“APB”) Opinion No. 30 “Reporting the Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions” (“APB No. 30”). The financial position, results of operations and cash flows of our healthcare solutions business have been classified as discontinued, and prior periods have been restated, including the reallocation of general overhead charges to our three remaining business segments. We recorded an after-tax gain of \$646 million in 2001 and an after-tax loss of \$10 million in 2002 as a result of the sale to Philips. In 2002, adjustments were made to the gain as a result of purchase price adjustments to reflect the final purchased net assets and additional costs that were not anticipated at the time of the sale.

We signed an agreement with Philips, dated as of May 15, 2002, finalizing the purchase price adjustments from the sale. The adjustments did not result in a material adjustment to the gain on sale. Since August 1, 2001, we received all of the \$100 million withheld by Philips from the total purchase price at the time of the sale plus adjustments for the final purchased net assets. For incremental fees, we provided support services to Philips after August 1, 2001 and a portion of these fees offset costs that include an element of fixed costs which are recognized in selling,

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

general and administrative expenses in 2001 and 2002. As of October 31, 2002, we have completed our contractual obligation to provide services to Philips.

The following table shows the components of the gain on sale of discontinued operations initially recorded and the subsequent adjustments.

	<u>Gain on sale of discontinued operations</u>
	<u>(in millions)</u>
Proceeds not subject to contingency	\$1,771
Book value of assets and liabilities sold	(495)
Book value of assets and liabilities written off	(98)
Net loss from operations post-measurement date	(58)
Costs of disposition	<u>(52)</u>
Gain on sale before taxes	1,068
Taxes	<u>(422)</u>
Gain from sale of discontinued operations, net of taxes for the year ended October 31, 2001	<u>\$ 646</u>
Adjustment to gain:	
Cash received after satisfaction of contingencies, including interest	\$ 20
Purchase price adjustment	(44)
Information technology and other costs	(2)
Retirement plan curtailment	<u>10</u>
Loss on sale before taxes	(16)
Tax benefit	<u>6</u>
Loss from sale of discontinued operations, net of taxes for the year ended October 31, 2002	<u>\$ (10)</u>

The following table shows the results of operations of our healthcare solutions business in 2001 and 2000. There were no results from operation in 2002.

	<u>Years Ended October 31,</u>	
	<u>2001(a)</u>	<u>2000</u>
	<u>(in millions)</u>	
Net revenue	\$765	\$1,412
Costs and expenses	<u>747</u>	<u>1,283</u>
Earnings from discontinued operations	18	129
Other income (expense), net	<u>3</u>	<u>17</u>
Earnings from discontinued operations before taxes	21	146
Provision for taxes	<u>15</u>	<u>61</u>
Net earnings from discontinued operations	<u>\$ 6</u>	<u>\$ 85</u>

(a) Includes operations from November 1, 2000 to May 31, 2001, the measurement date.

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

5. Acquisitions and Sale of Assets

On January 5, 2001, we acquired Objective Systems Integrators, Inc. (“OSI”) for approximately \$716 million. Of this total, \$690 million was cash and the remainder represents the fair value of options granted. Using the purchase method of accounting in accordance with APB Opinion No. 16, “Business Combinations” (“APB No. 16”), the purchase price was allocated to tangible and intangible assets including goodwill. The original goodwill balance of \$593 million was being amortized over three years. The net book value of goodwill associated with this acquisition at October 31, 2002 was \$234 million. At the time of the acquisition OSI was a leading provider of next-generation operations-support-system software for communications service providers and has become part of our test and measurement business.

In July 1999, Hewlett-Packard entered into an agreement with Yokogawa Electric Corporation (“Yokogawa”) to acquire Yokogawa’s 25 percent equity interest in Agilent Technologies Japan, Ltd. for approximately \$521 million (the “Yokogawa Purchase”). The acquisition was done in several steps. In the initial step, which occurred in January 2000, we purchased approximately 10 percent of Agilent Technologies Japan, Ltd. shares from Yokogawa for approximately \$206 million. In the second step, which occurred in April 2000, we purchased approximately 11 percent of additional Agilent Technologies Japan, Ltd. shares from Yokogawa for approximately \$216 million. In January 2001, we completed the Yokogawa Purchase by purchasing the remaining 4 percent interest for approximately \$99 million. Of the total purchase price, \$243 million was allocated to tangible assets and \$278 million was attributed to goodwill which was being amortized over ten years. The remaining net book value of goodwill associated with this acquisition was \$205 million at October 31, 2002.

In addition to the OSI acquisition and the Yokogawa Purchase, we acquired several other companies during 2002, 2001 and 2000, which were not significant to our consolidated financial position, results of operations or cash flows. These acquisitions were accounted for under the purchase method of accounting as defined in APB No. 16 or SFAS No. 141 depending on the date of acquisition. The results of operations of the acquired companies were included prospectively from the date of acquisition and the acquisition cost was allocated to the acquired tangible assets and liabilities and identifiable intangible assets based on fair values at the date of acquisition. Residual amounts were recorded as goodwill. In-process research and development write-offs have not been significant.

Unaudited pro forma statement of operations information has not been presented because the effects of these acquisitions were not material on either an individual or an aggregated basis.

The net book value of goodwill was \$610 million at October 31, 2002 and \$944 million at October 31, 2001. Goodwill related to acquisitions completed prior to June 30, 2001 was amortized over periods ranging from three to ten years. Effective in the first quarter of 2003, goodwill will no longer be amortized, in accordance with our adoption SFAS No. 142. Effective in the first quarter of 2003, approximately \$6 million of workforce-in-place will be reclassified from intangible assets to goodwill. Goodwill amortization was \$326 million in 2002, \$303 million in 2001 and \$64 million in 2000. The aggregate amount of goodwill impairment losses was \$12 million in 2002, \$8 million in 2001 and insignificant in 2000. See further discussion in Note 3, “New Accounting Pronouncements.”

The net book value of purchased other intangible assets was \$75 million at October 31, 2002 and \$126 million at October 31, 2001. Purchased intangible assets such as purchased technology (\$59 million as of October 31, 2002), workforce-in-place (\$6 million as of October 31, 2002) and customer relationships (\$10 million as of October 31, 2002) are amortized over periods from three

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

to four years. Amortization of purchased intangible assets was \$52 million in 2002, \$41 million in 2001 and \$7 million in 2000.

Sale of Leasing Portfolio. In the fourth quarter of 2000, we entered into an asset purchase agreement with CIT Group Inc. (“CIT,” formerly Tyco Capital Corporation) pursuant to which we sold them substantially all of our leasing portfolio (the “CIT Group Sale”) over the course of 2000 and 2001. There was no impact on our consolidated cash flows and results of operations from the CIT Group Sale in 2002. The impact on our consolidated cash flows and results of operations of the CIT Group Sale in the two previous years is shown below.

	Year Ended October 31, 2001	Year Ended October 31, 2000
	(in millions)	
Net proceeds from the CIT Group Sale	\$287	\$234
Product revenue	\$254	\$197
Cost of products	\$131	\$ 83

We also entered into a vendor financing arrangement with CIT whereby CIT will provide equipment financing and leasing services to our customers on a global basis. This agreement has been in place since the fourth quarter of 2000.

In addition to the CIT Group Sale and the sale of the healthcare solutions business, we sold assets related to portions of our businesses to third parties during 2002, 2001, and 2000. Gross proceeds from these dispositions were \$31 million in 2002, \$13 million in 2001, and insignificant in 2000. Gains from the dispositions, included in other income (expense), net, in the consolidated statement of operations, were \$15 million in 2002, \$9 million in 2001, and insignificant in 2000.

6. Adoption of SAB 101

In December 1999, the U.S. Securities and Exchange Commission (the “SEC”) issued Staff Accounting Bulletin No. 101, “Revenue Recognition in Financial Statements” (“SAB 101”). During the fourth quarter of 2001, we adopted SAB 101 retroactive to the beginning of the year. The cumulative effect of the adoption resulted in a charge to 2001 net earnings of \$47 million (net of income taxes of \$27 million) or \$0.10 per basic and diluted share. As a result of adopting SAB 101, delivery is considered to have occurred when title and risk of loss have transferred to the customer. For the year ended October 31, 2001, the net impact on 2001 revenues including amounts deferred at October 31, 2001 was an increase of \$67 million of revenue and \$29 million of cost of products which were included in the cumulative effect adjustment. Pro forma amounts for the year ended October 31, 2000 have not been presented, as the effect of the change could not reasonably be determined.

7. Adoption of SFAS No. 133

Effective November 1, 2000, we adopted SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities,” as amended by SFAS No. 138, “Accounting for Certain Derivative Instruments and Certain Hedging Activities” (“SFAS No. 133”). SFAS No. 133, as amended, establishes accounting and reporting standards for derivative instruments, and requires that all derivatives be recognized as either assets or liabilities on the balance sheet and carried at fair value. Changes in the fair value of the derivative instruments are recognized in earnings or stockholders’ equity, depending on the intended use of the instrument.



AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

If derivative instruments are designated and qualify as a fair value hedge, changes in value of the derivative are recognized in earnings in the current period, along with the offsetting gain or loss on the hedged item attributable to the hedged risk. If derivative instruments are designated and qualify as a cash flow hedge, changes in the value of the effective portion of the derivative instrument are recognized in other comprehensive income, a component of stockholders' equity. These amounts are reclassified and recognized in earnings when either the forecasted transaction occurs or it becomes probable the forecasted transaction will not occur. Changes in the fair value of the ineffective portion of derivative instruments are recognized in earnings in the current period. Ineffectiveness in 2002 and 2001 was not significant.

The adoption of SFAS No. 133 on November 1, 2000 resulted in a cumulative pre-tax reduction to income of \$41 million (\$25 million after tax) and a pre-tax increase in other comprehensive income of \$10 million.

8. (Loss) Earnings Per Share

The following is a reconciliation of the numerators and denominators of the basic and diluted net (loss) earnings per share computations for the periods presented below.

	For the Years Ended October 31,		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
	<small>(in millions, except per share data)</small>		
Numerator:			
(Loss) earnings from continuing operations	\$(1,022)	\$(406)	\$672
Earnings from discontinued operations, net of taxes	—	6	85
(Loss) gain from the sale of discontinued operations, net of taxes	<u>(10)</u>	<u>646</u>	<u>—</u>
(Loss) earnings before cumulative effect of changes in accounting principles	(1,032)	246	757
Cumulative effect of adopting SFAS No. 133, net of taxes	—	(25)	—
Cumulative effect of adopting SAB 101, net of taxes	<u>—</u>	<u>(47)</u>	<u>—</u>
Net (loss) earnings	<u><u>\$(1,032)</u></u>	<u><u>\$ 174</u></u>	<u><u>\$757</u></u>
Denominators:			
Basic weighted average shares	465	458	449
Potentially dilutive common stock equivalents – stock options and other employee stock plans	<u>—</u>	<u>—</u>	<u>6</u>
Diluted weighted average shares	<u><u>465</u></u>	<u><u>458</u></u>	<u><u>455</u></u>

Options to purchase 73.8 million shares of common stock at a weighted average exercise price of \$40 per share were outstanding in 2002, but were not included in the computation of diluted net (loss) earnings per share because the options were antidilutive for 2002. The options, which expire no later than 2012, were still outstanding at the end of 2002. In 2001, options to purchase 63.9 million shares of common stock at a weighted average exercise price of \$46 per share were outstanding, but were not included in the computation of diluted net earnings per share because the options were antidilutive.

See Note 17, "Senior Convertible Debentures and Lines of Credit," for a discussion of our senior convertible debentures, which may be dilutive in 2003.

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

9. Supplemental Cash Flow Information

Cash paid for income taxes was \$160 million in 2002, \$450 million in 2001 and \$546 million in 2000. Cash paid for interest was \$36 million in 2002, \$28 million in 2001 and was not material in 2000.

Non-cash transactions were primarily related to the issuance of common stock under various employee stock plans in the amount of \$23 million in 2002, \$26 million in 2001 and \$44 million in 2000, and acquisitions in the amount of \$70 million in 2001 and \$25 million in 2000.

10. Inventory

	October 31,	
	2002	2001
	(in millions)	
Finished goods	\$ 377	\$ 400
Work in progress	130	239
Raw materials	677	852
	<u>\$1,184</u>	<u>\$1,491</u>

Inventory-related charges of \$40 million, \$459 million and \$70 million were recorded in total cost of products in 2002, 2001 and 2000, respectively. We record excess and obsolete inventory charges for both inventory on our site as well as inventory at our contract manufacturers and suppliers where we have non-cancelable purchase commitments. As required by the guidance in SAB 100 inventory write-downs represent a new cost basis and therefore not a valuation allowance.

11. Property, Plant and Equipment, Net

	October 31	
	2002	2001
	(in millions)	
Land	\$ 148	\$ 148
Buildings and leasehold improvements	1,625	1,767
Machinery and equipment	2,300	2,210
Total property, plant and equipment	4,073	4,125
Accumulated depreciation	(2,494)	(2,277)
	<u>\$ 1,579</u>	<u>\$ 1,848</u>

The net book value of capitalized software was \$171 million at October 31, 2002 and \$64 million at October 31, 2001. These amounts primarily relate to the development of our website, Enterprise Resource Planning (“ERP”) system and Customer Relationship Management (“CRM”) software.

We have sold substantially all of our portfolio of operating leases to CIT. See Note 5, “Acquisitions and Sale of Assets.” Equipment under operating leases was \$10 million at October 31, 2002 and \$23 million at October 31, 2001 and was included in machinery and equipment. Accumulated depreciation related to equipment under operating leases was \$5 million at October 31, 2002 and \$4 million at October 31, 2001.

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

12. Taxes on Earnings

The (benefit) provision for income taxes is comprised of:

	<u>Years Ended October 31,</u>		
	<u>2002</u>	<u>2001(a)</u>	<u>2000</u>
	(in millions)		
U.S. federal taxes from continuing operations:			
Current	\$ —	\$ 22	\$ 77
Deferred	(501)	(105)	(42)
Non-U.S. taxes from continuing operations:			
Current	142	(38)	310
Deferred	(113)	20	(18)
State taxes from continuing operations, net of federal benefit . . .	<u>(53)</u>	<u>(13)</u>	<u>19</u>
Total from continuing operations:	<u>\$(525)</u>	<u>\$(114)</u>	<u>\$346</u>

- (a) The benefit for income taxes in 2001 includes \$71 million tax benefit from operations, \$16 million tax benefit from adoption of SFAS No. 133 and \$27 million tax benefit from adoption of SAB 101

The significant components of deferred tax assets, for which no valuation allowance was required, and deferred tax liabilities included on the consolidated balance sheet are:

	<u>October 31,</u>			
	<u>2002</u>		<u>2001</u>	
	<u>Deferred Tax Assets</u>	<u>Deferred Tax Liabilities</u>	<u>Deferred Tax Assets</u>	<u>Deferred Tax Liabilities</u>
	(in millions)			
Inventory	\$ 175	\$ 4	\$229	\$ 9
Property, plant and equipment.....	72	8	62	6
Warranty reserves	30	3	30	—
Retiree medical benefits	51	—	54	—
Other retirement benefits	78	44	—	44
Employee benefits, other than retirement	242	9	189	4
Net operating losses and credit carryforwards.....	641	—	32	—
Unremitted earnings of foreign subsidiaries	—	238	—	203
Other	<u>134</u>	<u>33</u>	<u>103</u>	<u>24</u>
	<u>\$1,423</u>	<u>\$339</u>	<u>\$699</u>	<u>\$290</u>

At October 31, 2002, we had net operating loss carryforwards of approximately \$1,115 million and tax credit carryforwards of approximately \$245 million. The net operating loss and tax credit carryforwards will expire beginning in 2005 through 2022 if not utilized.

Tax benefits of \$6 million in 2002, \$11 million in 2001 and \$16 million in 2000 associated with the exercise of employee stock options were recognized in stockholders' equity.

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The differences between the U.S. federal statutory income tax rate and our effective tax rate are:

	<u>Years Ended October 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
U.S. federal statutory income tax rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit	3.5	2.2	2.1
Lower rates in other jurisdictions, net	2.1	6.1	(4.0)
Goodwill	(9.1)	(19.8)	2.0
Credits	4.1	2.0	(0.5)
Other, net	(1.6)	(6.5)	(0.6)
	<u>34.0%</u>	<u>19.0%</u>	<u>34.0%</u>

The domestic and foreign components of (loss) earnings from continuing operations before taxes are:

	<u>Years Ended October 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
	(in millions)		
U.S. continuing operations	\$(1,804)	\$(487)	\$ 66
Non-U.S. continuing operations	<u>257</u>	<u>(105)</u>	<u>952</u>
	<u>\$(1,547)</u>	<u>\$(592)</u>	<u>\$1,018</u>

As a result of certain employment and capital investment actions undertaken by us, income from manufacturing activities in certain countries is subject to reduced tax rates, or is wholly exempt from taxes, for tax years through 2010. The income tax benefits attributable to the tax status of subsidiaries in these countries were estimated to be \$33 million in 2002, \$37 million in 2001 and \$41 million in 2000.

We have not provided for U.S. federal income and foreign withholding taxes on \$970 million of non-U.S. subsidiaries' undistributed earnings as of October 31, 2002 because we intend to reinvest such earnings indefinitely. Where excess cash has accumulated in our non-U.S. subsidiaries and it is advantageous for tax or foreign exchange reasons, subsidiary earnings are remitted.

13. Restructuring and Asset Impairment

Summary

We currently have two active restructuring plans – one initiated in the fourth quarter of 2001 (the “2001 Plan”) and the other initiated in the fourth quarter of 2002 (the “2002 Plan”) after it became clear that the actions taken in the previous year would not be sufficient to return the company to profitability. Both plans were designed to reduce costs and expenses in order to return the company to profitability without relying on an improvement in economic conditions.

Actions have been focused on segments that were impacted most severely by the changing environment – our test and measurement and semiconductor products groups – but actions were also taken to reduce the costs associated with support services such as finance and administration. Cost reductions were initiated by reducing the number of properties, particularly sales and administrative sites and by reducing our workforce within the impacted segments.

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Our 2001 Plan was substantially complete as of October 31, 2002. The 2002 Plan is still being implemented – we expect to complete it no later than the first quarter of 2004.

The 2001 Plan

In 2001, as a result of the economic downturn that impacted many of the markets that we serve, we took steps to restructure our businesses. On August 20, 2001, we announced a plan to reduce our workforce by approximately 4,000, or about nine percent, by the middle of 2002. On November 15, 2001, we enhanced and supplemented our plan by announcing a further reduction of 4,000 jobs once we had determined that the actions contemplated in August would not be sufficient to return us to profitability. Together these actions form the 2001 Plan, which was designed to reduce costs across almost all of our administrative and support services, including sales and marketing, and to focus our production activities on those products that we believed would return us to profitability, such as those in life sciences, semiconductor test and wireless telecommunications. Our plan impacted the test and measurement group and the semiconductor products group and had little direct impact on the life sciences and chemical analysis group except as the plan related to support services reductions across all of our businesses. Within the test and measurement segment, we reduced production capacity dramatically for communications test product lines and reduced production to some degree in general purpose and semiconductor test product lines. Within the semiconductor products segment we reduced production capacity significantly for product lines in networking, especially long-haul networks, and reduced production capacity for some personal systems products. The 2001 Plan was substantially complete as of October 31, 2002, although we will continue to make lease payments on a number of properties vacated as a result of this plan through at least the next 5 years.

A summary of restructuring activity for the 2001 Plan through October 31, 2002 is shown in the table below:

	<u>Workforce Reduction</u>	<u>Consolidation of Excess Facilities</u>	<u>Impairment of Assets, Property, plant And equipment</u>	<u>Total</u>
	(in millions)			
Beginning balance at July 31, 2001 ..	\$ —	\$ —	\$ —	\$ —
Total charge	117	20	17	154
Cash payments	<u>(65)</u>	<u>—</u>	<u>—</u>	<u>(65)</u>
Ending balance at October 31, 2001 ..	52	20	17	89
Total charge	175	53	129	357
Asset impairment	—	—	(146)	(146)
Cash payments	<u>(210)</u>	<u>(10)</u>	<u>—</u>	<u>(220)</u>
Ending balance at October 31, 2002 ..	<u>\$ 17</u>	<u>\$ 63</u>	<u>\$ —</u>	<u>\$ 80</u>

The three main components of the 2001 Plan relate to workforce reductions, consolidation of excess facilities and impairment of property, plant and equipment.

Workforce related charges were incurred due to the 8,000-person workforce reduction; the cuts impacted all regions, all expense categories and most of our segments. Research and development activities were terminated on some product development initiatives, none of which were individually or in total significant to our future revenues or profitability. We also took action to reduce the number of employees at production facilities that had experienced declining demand, such as those making equipment for the long-haul wireline business.

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Our plan to consolidate excess facilities resulted in charges for lease termination fees and losses anticipated from sub-lease agreements. We have exited, or plan to exit in the near future, more than 100 production, support and sales facilities, or parts of facilities, across all regions particularly in the U.S. and Japan, representing more than 3.6 million square feet, or about 19 percent, of our worldwide property. As of October 31, 2002, we have vacated approximately 40 percent of these facilities. The decision to exit individual facilities was made as a result of specific economic conditions in certain countries and as part of our strategy to centralize support services and to consolidate facilities. We lease most of these buildings from third parties, and the closures impacted all three of our segments. In most cases, we are exiting office space housing sales and administrative employees. However, a small number of production facilities were closed as a result of our plans to consolidate manufacturing into fewer sites.

Asset impairment charges relate to fixed assets and were determined using estimates of the expected future cash flows generated from those assets. Impairments were recorded for machinery and equipment in production facilities that we were closing or scaling back, such as for the long-haul wireline business and for leasehold improvements in leased facilities that we planned to exit. One production facility in Kobe, Japan accounted for approximately \$60 million of the \$129 million of asset impairment charges in 2002. In order to determine the amount of the impairment, under the held-for-use model in accordance with SFAS No. 121, we estimated the cash flows that would result from our continued use of the building until we expect to vacate it and also estimated the sales proceeds that we expected to be able to realize. The resulting impairment was approximately 80 percent of the net book value of the facility, primarily due to the decline in the local property market.

We have incurred \$511 million of the expenses for the 2001 Plan through October 31, 2002, \$154 million in 2001 and \$357 million in 2002. The most significant revision to the plan was made in the fourth quarter of 2002 after updating our lease termination costs and sub-lease income assumptions as the real estate leasing market continued to decline, adding a number of leased sales offices and two owned production facilities to the list that we were planning to exit, including the facility in Kobe, Japan, described above; we incurred incremental asset impairment costs of \$94 million and lease facility costs of \$36 million in relation to these changes.

We have reduced our workforce by approximately 7,700 (approximately 6,400 from involuntary terminations and approximately 1,300 from net attrition) as of October 31, 2002. We paid approximately \$210 million in cash for severance payments in 2002. The cash payments were funded using cash generated from operations, existing working capital and credit facilities, where necessary.

The 2002 Plan

On August 19, 2002, we announced our intention to further reduce our operational costs by \$50 million per quarter so that we might reach profitability at target revenue levels of \$1.6 billion per quarter. We concluded that we must further reduce our breakeven point given our current level of revenues because the wireline and communications markets are recovering more slowly than we anticipated. This plan primarily affects the manufacturing and field operations serving the wireline markets that are components of our test and measurement group.

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

A summary of restructuring activity for the 2002 Plan through October 31, 2002 is shown in the table below:

	<u>Workforce Reduction</u>	<u>Impairment of Assets, Property, plant And equipment (in millions)</u>	<u>Total</u>
Beginning balance at July 31, 2002	\$ —	\$ —	\$ —
Total charge	83	34	117
Asset impairment	—	(34)	(34)
Cash payments	<u>(15)</u>	<u>—</u>	<u>(15)</u>
Ending balance at October 31, 2002	<u>\$ 68</u>	<u>\$ —</u>	<u>\$ 68</u>

As part of the 2002 Plan we have reduced our workforce by approximately 300 as of October 31, 2002. We expect to reduce our workforce by 2,500 in total by the time the plan is completed. We expect to achieve the majority of the \$50 million reduction in quarterly operational costs by mid-2003.

Asset impairment charges of \$34 million relate to machinery and equipment, primarily owned by the semiconductor products group in Singapore. The equipment had been purchased in support of communications research, but as a result of our restructuring plans, we have decided to sell the equipment and conduct the research using existing equipment in the U.S.

A summary of the income statement impact of the combined plans in 2002 and 2001 is shown below. There were no significant restructuring activities in 2000.

	<u>Years ended October 31,</u>	
	<u>2002</u>	<u>2001</u>
	<u>(in millions)</u>	
Cost of products and services	\$210	\$ 79
Research and development	56	17
Selling, general and administrative	<u>208</u>	<u>58</u>
Total restructuring and asset impairment charges	<u>\$474</u>	<u>\$154</u>

Other asset impairment charges

In June 2001, we recognized a \$74 million asset impairment charge with respect to our decision to cancel the development of a software system for our customer support activities. We entered into an agreement with Hewlett-Packard to extend our use of their legacy customer support systems in place of the one that we were developing.

14. Stock-Based Compensation

Employee stock purchase plans. Prior to February 2, 2000, virtually all of our employees were able to contribute up to ten percent of their base compensation to the quarterly purchase of Hewlett-Packard's common stock under the Hewlett-Packard Stock Purchase Plan (the "Hewlett-Packard Plan"). Under the provisions of the Hewlett-Packard Plan, employee contributions to purchase shares were partially matched with shares contributed by Hewlett-Packard. These matching shares generally vested over two years. After February 2, 2000, we implemented the Agilent Technologies, Inc. Employee Stock Purchase Plan (the "Legacy Plan") that was similar to

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

the Hewlett-Packard Plan and allowed eligible employees to contribute up to ten percent of their base compensation to the purchase of our common stock. Under the provisions of the Legacy Plan, employee contributions were partially matched with shares contributed by us. These matching shares also generally vested over two years. On June 2, 2000, all unvested matching shares of Hewlett-Packard stock held by our employees were forfeited and replaced by our common stock of equivalent value. Compensation expense for the matching provision for both the Hewlett-Packard Plan and the Legacy Plan was measured using the fair value of shares on the date of purchase by Hewlett-Packard for the Hewlett-Packard Plan and by Agilent for the Legacy Plan and was recognized over the two-year vesting period. Compensation expense under both plans was \$16 million in 2002, \$28 million in 2001 and \$34 million in 2000. At October 31, 2002, 9,802,100 shares of our common stock had been authorized for issuance under the Legacy Plan and 3,359,279 of these shares had been issued.

Effective October 31, 2000, purchases and contributions under the Legacy Plan ceased. All unvested matching shares under the Legacy Plan maintained their original vesting terms based on the employee's continued employment. Vesting of these matching shares was completed by October 31, 2002.

Effective November 1, 2000, we adopted a new plan, the Agilent Technologies, Inc. Employee Stock Purchase Plan (the "423(b) Plan"). Under the provisions of the 423(b) Plan, eligible employees may contribute up to ten percent of their base compensation to purchase shares of our common stock at 85 percent of the lower of the fair market value at the entry date or the purchase date as defined by the 423(b) Plan. As of October 31, 2002, 35,000,000 shares of our common stock were authorized for issuance under the 423(b) Plan and 6,407,624 of these shares have been issued.

Incentive compensation plans. On September 17, 1999, we adopted the Agilent Technologies, Inc. 1999 Stock Plan (the "Stock Plan") and subsequently reserved 67,800,000 shares of our common stock for issuance under the Stock Plan. In February 2001, our stockholders approved an additional 45,000,000 shares of our common stock for issuance under the Stock Plan. These shares were subsequently registered in May 2002. Stock options, stock appreciation rights, stock awards and cash awards may be granted under the Stock Plan. Options granted under the Stock Plan may be either "incentive stock options," as defined in section 422 of the Internal Revenue Code, or non-statutory. Options generally vest at a rate of 25 percent per year over a period of four years from the date of grant and have a maximum term of ten years. The exercise price for incentive stock options is not less than 100 percent of the fair market value of our common stock on the date the stock award is granted.

At October 31, 2002, shares registered and available for option and restricted stock grants were 51,949,609. Compensation expense for discounted options, stock appreciation rights and restricted stock is recognized based on the intrinsic value method defined by APB Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25"). Any compensation expense is recognized ratably over the associated service period, which is generally the vesting period. The compensation expense related to discounted options, stock appreciation rights and restricted stock was \$7 million in 2002, \$8 million in 2001 and \$24 million in 2000.

Effective June 2000, a majority of the Hewlett-Packard awards held by our employees were converted to Agilent awards of equivalent value. The conversion of Hewlett-Packard options into Agilent options was done in such a manner that (1) the aggregate intrinsic value of the options immediately before and after the exchange was the same, (2) the ratio of the exercise price per option to the market value per option was not reduced, and (3) the vesting provisions and options

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

period of the replacement Agilent options were the same as the original vesting terms and option period of the Hewlett-Packard options.

The following table summarizes option activity for the years ended October 31, 2002, 2001 and 2000:

	<u>Shares</u> <u>(in thousands)</u>	<u>Weighted Average Exercise Price</u>
Outstanding options as of November 1, 1999	—	\$ —
Converted from Hewlett-Packard	17,687	\$31
Granted	30,425	\$59
Exercised	(645)	\$23
Cancelled	<u>(1,333)</u>	\$59
Outstanding as of October 31, 2000	46,134	\$48
Granted	20,814	\$40
Exercised	(1,114)	\$20
Cancelled	<u>(1,879)</u>	\$72
Outstanding as of October 31, 2001	63,955	\$46
Granted	20,152	\$25
Exercised	(1,128)	\$12
Cancelled	<u>(9,140)</u>	\$51
Outstanding as of October 31, 2002	<u>73,839</u>	\$40

The following table summarizes options exercisable and the fair value of options granted:

	<u>Shares</u> <u>(in thousands)</u>	<u>Weighted Average Exercise Price</u>
Options exercisable as of October 31, 2000	10,914	\$26
Fair market value of options granted and converted during 2000		\$48
Options exercisable as of October 31, 2001	25,196	\$40
Fair market value of options granted during 2001		\$27
Options exercisable as of October 31, 2002	31,501	\$41
Fair market value of options granted during 2002		\$15

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following table summarizes information about all options outstanding at October 31, 2002:

<u>Range of Exercise Prices</u>	<u>Options Outstanding</u>			<u>Options Exercisable</u>	
	<u>Number Outstanding</u> (in thousands)	<u>Weighted Average Remaining Contractual Life</u>	<u>Weighted Average Exercise Price</u>	<u>Number Exercisable</u> (in thousands)	<u>Weighted Average Exercise Price</u>
\$0 - 25	23,838	7.9 years	\$ 23	5,484	\$ 17
\$26 - 50	35,588	7.3 years	\$ 37	19,550	\$ 37
\$51 - 75	3,516	7.9 years	\$ 61	1,612	\$ 61
\$76 - 100	10,661	7.4 years	\$ 78	4,715	\$ 77
\$101 and over	<u>236</u>	7.4 years	\$ 119	<u>140</u>	\$ 119
	<u>73,839</u>		\$ 40	<u>31,501</u>	\$ 41

Pro forma information. We have elected to follow the accounting provisions of APB No. 25 for stock-based compensation granted to employees. Accordingly, compensation expense is recognized only when options are granted with a discounted exercise price. Any compensation expense is recognized ratably over the associated service period, which is generally the option vesting term.

Pro forma net (loss) earnings and net (loss) earnings per share information, as required by SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"), has been determined as if we had accounted for all employee stock options granted, including shares under the 423(b) Plan to employees under SFAS No. 123's fair value method. The fair value of these options was estimated at grant date using a Black-Scholes option-pricing model with the following weighted-average assumptions:

	<u>2002</u>	<u>2001</u>	<u>2000</u>
Risk-free interest rate for options	2.9%	4.25%	5.75%
Risk-free interest rate for the 423(b) Plan	1.89-5.87%	3.68-6.04%	—
Dividend yield	0%	0%	0%
Volatility for options	63%	77%	67%
Volatility for the 423(b) Plan	47-77%	77%	—
Expected option life	5.5 years	5.5 years	7 years
Expected life for the 423(b) Plan	6 months-2 years	6 months-2 years	—

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the four-year average vesting period of the options. The pro forma effect of recognizing compensation expense in accordance with SFAS No. 123 is as follows:

	<u>2002</u>	<u>2001</u>	<u>2000</u>
	(in millions, except per share amounts)		
Net (loss) earnings – as reported	\$(1,032)	\$ 174	\$ 757
SFAS No.123 based compensation, net of tax	<u>(311)</u>	<u>(503)</u>	<u>(281)</u>
Net (loss) earnings – pro forma	<u>\$(1,343)</u>	<u>\$(329)</u>	<u>\$ 476</u>
Basic net (loss) earnings per share – as reported	\$ (2.22)	\$ 0.38	\$ 1.68
Basic net (loss) earnings per share – pro forma	\$ (2.89)	\$(0.72)	\$ 1.06
Diluted net (loss) earnings per share – as reported	\$ (2.22)	\$ 0.38	\$ 1.66
Diluted net (loss) earnings per share – pro forma	\$ (2.89)	\$(0.72)	\$ 1.05

15. Retirement Plans and Post Retirement Benefits

General. Substantially all of our employees are covered under various defined benefit and/or defined contribution plans. Additionally, we sponsor post retirement health care benefits and a death benefit under the Agilent Survivor Protection Plan for our eligible U.S. employees.

Restructuring. Beginning in late 2001, we carried out plans to reduce our workforce by approximately 8,000 employees. In the U.S., employees affected by restructuring were offered a choice of remaining in the Agilent Retirement Plan (the “Retirement Plan”) or taking a distribution from the Retirement Plan. In the funded status table below, amounts relating to settlements of benefit obligations due to employees affected by restructuring are treated as regular plan payments. Additionally, eligible employees (i.e., those who met eligibility requirements as of their individual termination dates) were offered the opportunity to elect to receive benefits under the Agilent Continued Group Medical or SeniorMed Programs. Outside the U.S., subject to local statutory and other practical limitations, employees affected by restructuring were offered the choice of remaining in the applicable retirement plans or taking distributions from those plans.

Sale of healthcare solutions business. In the U.S., employees of the healthcare solutions business (“HSG Employees”) were offered a choice of remaining in the Retirement Plan or taking a distribution from the Retirement Plan. In the funded status table below, amounts relating to settlements of HSG Employees’ benefit obligations are treated as regular plan payments. Additionally, eligible HSG Employees (i.e., those who qualified for retirement on August 1, 2001) were offered the opportunity to elect to receive benefits under the Agilent Continued Group Medical or SeniorMed Programs. Outside the U.S., subject to local statutory and other practical limitations, HSG Employees’ projected benefit obligations – calculated in accordance with the Asset Purchase Agreement – were transferred to Philips along with an equal amount of assets. Amounts reported in this footnote reflect our continuing operations excluding the healthcare solutions business, except where noted.

Workforce-related events such as restructuring cause curtailment and settlement gains or losses when they have a material impact on the average future working lifetime or total number of participants in our retirement and postretirement plans. The restructuring program and the sale of our healthcare solutions business described above both resulted in material changes to our plan demographics in the U.S. and several other countries. The curtailment and settlement gains and losses related to each event are separately identified in the tables that follow.

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Spin-off from Hewlett-Packard. On or before June 2, 2000, we assumed responsibility for pension, deferred profit-sharing, 401(k) and other post retirement benefits from Hewlett-Packard for current and former employees whose last work assignment prior to the spin-off was with Agilent. These current and former employees are collectively referred to as “Agilent Employees.” In the U.S., the Hewlett-Packard Company Retirement Plan and Deferred Profit-Sharing Plan Master Trust was converted to the Group Trust for the Hewlett-Packard Company Deferred Profit-Sharing Plan and Retirement Plan and the Agilent Technologies, Inc. Deferred Profit-Sharing Plan and Retirement Plan (the “Group Trust”), and a pro rata share of the assets of the Group Trust was assigned to the Agilent Deferred Profit-Sharing Plan Trust and the Agilent Retirement Plan Trust. Outside the U.S., generally, a pro rata share of the Hewlett-Packard pension assets, if any, were transferred or otherwise assigned to the Agilent entity in accordance with local law or practice. The pro rata share was in the same proportion as the projected benefit obligation for Agilent Employees was to the total projected benefit obligation of Hewlett-Packard and Agilent combined. For all periods presented, the consolidated financial statements include the trust assets, liabilities and expenses that were assigned to Agilent.

Pension and deferred profit-sharing plans. Worldwide pension costs included in (loss) earnings from continuing operations were \$112 million in 2002, \$106 million in 2001 and \$69 million in 2000.

U.S. employees who meet eligibility criteria under the Retirement Plan are provided pension benefits under the Retirement Plan. Defined benefits are generally based on an employee’s average pay during the final five years of employment and length of service. For eligible service through October 31, 1993, the benefit payable under the Retirement Plan is reduced by any amounts due to the eligible employee under our fixed and frozen defined contribution Deferred Profit-Sharing Plan (“DPSP”), which was closed to new participants in November 1993.

As of October 31, 2002 and 2001, the status of the Retirement Plan and DPSP for U.S. Agilent Employees follows.

	<u>Retirement Plan</u>		<u>DPSP</u>	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
	(in millions)			
Fair value of plan assets	\$407	\$451	\$952	\$1,266
Retirement benefit obligation	\$761	\$702	\$952	\$1,266

Eligible employees outside the U.S. generally receive retirement benefits under various retirement plans based upon factors such as years of service and employee compensation levels. Eligibility is generally determined in accordance with local statutory requirements.

Post retirement benefit plans. In addition to receiving pension benefits, U.S. Agilent Employees who meet retirement eligibility requirements as of their termination dates may participate in our Continued Group Medical or SeniorMed Plans. Substantially all of our current U.S. employees could become eligible for these benefits, and the existing benefit obligation relates primarily to those employees. Once participating in a medical plan, retirees may choose from managed-care and indemnity options, with their contributions dependent on the options chosen and length of service. Our U.S. retirees are also covered by a death benefit that is part of the Agilent Survivor Protection Plan. This benefit provides a fixed sum to retirees’ survivors and is available to all retirees regardless of length of service or compensation.

401(k) defined contribution plan. Our U.S. eligible employees may participate in the Agilent Technologies, Inc. 401(k) Plan (“the 401(k) Plan”). Assets and liabilities related to Agilent

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Employees were transferred to us by Hewlett-Packard effective June 2, 2000. Enrollment in the 401(k) Plan is automatic for employees who meet eligibility requirements unless they decline participation. Under the 401(k) Plan, we provide matching contributions to employees up to a maximum of 4 percent of an employee's annual eligible compensation. The maximum contribution to the 401(k) Plan is 20 percent of an employee's annual eligible compensation, subject to regulatory and plan limitations. Our expense included in earnings (loss) from continuing operations related to the 401(k) Plan was \$43 million in 2002, \$53 million in 2001 and \$48 million in 2000.

Components of net periodic cost. For the years ended October 31, 2002, 2001 and 2000, our net pension and post retirement benefit costs were comprised of:

	Pensions						U.S. Post Retirement Benefit Plans		
	U.S. Plans			Non-U.S. Plans			2002	2001	2000
	2002	2001	2000	2002	2001	2000			
	(in millions)								
Service cost – benefits earned during the period	\$ 83	\$ 87	\$ 74	\$ 42	\$ 44	\$ 51	\$ 13	\$ 13	\$ 10
Interest cost on benefit obligation	46	41	35	41	42	39	27	24	18
Expected return on plan assets	(41)	(56)	(51)	(59)	(59)	(58)	(28)	(36)	(33)
Amortization and deferrals:									
Actuarial loss (gain)	10	(10)	(12)	13	6	(1)	(8)	(18)	(10)
Transition asset	–	–	(3)	–	–	–	–	–	–
Prior service cost	<u>1</u>	<u>1</u>	<u>2</u>	<u>–</u>	<u>1</u>	<u>1</u>	<u>–</u>	<u>–</u>	<u>(4)</u>
Net plan costs (income)	99	63	45	37	34	32	4	(17)	(19)
Curtailed loss (gain)	1	(28)	–	(1)	(4)	–	(41)	(7)	–
Settlement loss	5	1	–	7	21	–	–	–	–
Special termination benefits	–	–	–	1	–	–	–	–	–
Other	<u>–</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>7</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>–</u>
Total net plan costs (income)	<u>\$105</u>	<u>\$ 36</u>	<u>\$ 45</u>	<u>\$ 44</u>	<u>\$ 58</u>	<u>\$ 32</u>	<u>\$(37)</u>	<u>\$(24)</u>	<u>\$(19)</u>
Distribution of net plan costs (income):									
Continuing operations	\$105	\$ 32	\$ 40	\$ 44	\$ 55	\$ 29	\$(37)	\$(23)	\$(17)
Discontinued operations	<u>–</u>	<u>4</u>	<u>5</u>	<u>–</u>	<u>3</u>	<u>3</u>	<u>–</u>	<u>(1)</u>	<u>(2)</u>
Total net plan costs (income)	<u>\$105</u>	<u>\$ 36</u>	<u>\$ 45</u>	<u>\$ 44</u>	<u>\$ 58</u>	<u>\$ 32</u>	<u>\$(37)</u>	<u>\$(24)</u>	<u>\$(19)</u>

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Funded status. As of October 31, 2002 and 2001, the funded status of the defined benefit and post retirement benefit plans was:

	U.S. Defined Benefit Plans		Non-U.S. Defined Benefit Plans		U.S. Post Retirement Benefit Plans	
	2002	2001	2002	2001	2002	2001
	(in millions)					
Change in fair value of plan assets:						
Fair value – beginning of year	\$ 451	\$ 655	\$ 746	\$ 807	\$ 311	\$ 426
Net addition (deletion) of plans	–	–	6	–	–	–
Actual return on plan assets	(68)	(164)	(213)	(64)	(49)	(108)
Employer contributions	84	1	105	60	1	–
Participants’ contributions	–	–	8	8	4	4
Benefits paid	(60)	(41)	(21)	(10)	(11)	(11)
Special termination benefits	–	–	1	–	–	–
Currency impact	–	–	29	(9)	–	–
Curtailed/settlement impact – divestiture of Healthcare Solutions Business	–	–	–	(60)	–	–
Curtailed/settlement impact – restructuring	–	–	(16)	–	–	–
Other	–	–	12	14	–	–
Fair value – end of year	<u>\$ 407</u>	<u>\$ 451</u>	<u>\$ 657</u>	<u>\$ 746</u>	<u>\$ 256</u>	<u>\$ 311</u>
Change in benefit obligation:						
Benefit obligation – beginning of year	702	585	821	821	380	317
Net addition (deletion) of plans	–	–	19	–	–	–
Service cost	83	87	42	44	13	13
Interest cost	46	41	41	42	27	24
Participants’ contributions	–	–	8	8	4	4
Plan amendment	–	–	3	(17)	–	–
Actuarial loss	19	73	30	4	66	40
Benefits paid	(60)	(41)	(21)	(13)	(11)	(11)
Special termination benefits	–	–	1	–	–	–
Currency impact	–	–	44	(12)	–	–
Curtailed/settlement impact – divestiture of Healthcare Solutions Business	–	(43)	–	(63)	(10)	(7)
Curtailed/settlement impact – restructuring	(29)	–	(31)	–	(32)	–
Other	–	–	–	7	–	–
Benefit obligation – end of year	<u>\$ 761</u>	<u>\$ 702</u>	<u>\$ 957</u>	<u>\$ 821</u>	<u>\$ 437</u>	<u>\$ 380</u>

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	U.S. Defined Benefit Plans		Non-U.S. Defined Benefit Plans		U.S. Post Retirement Benefit Plans	
	2002	2001	2002	2001	2002	2001
	(in millions)					
Plan assets less than benefit obligation	\$(354)	\$(251)	\$(300)	\$(75)	\$(181)	\$(69)
Unrecognized net actuarial loss (gain)	213	129	483	191	2	(102)
Unrecognized prior service cost (benefit) related to plan changes	5	8	(5)	(8)	49	3
Unrecognized net transition asset*	—	—	—	(1)	—	—
Net (accrued) prepaid costs	<u>\$(136)</u>	<u>\$(114)</u>	<u>\$ 178</u>	<u>\$ 107</u>	<u>\$(130)</u>	<u>\$(168)</u>
Amounts recognized in the consolidated balance sheet consist of:						
Prepaid defined benefit plan costs	\$ —	\$ —	\$ 187	\$ 111	\$ —	\$ —
Accrued defined benefit plan costs	(136)	(114)	(239)	(4)	—	—
Intangible assets	—	—	6	—	—	—
Additional minimum pension liability	—	—	224	—	—	—
Accrued post retirement benefits costs	—	—	—	—	(130)	(168)
Net (accrued) prepaid costs	<u>\$(136)</u>	<u>\$(114)</u>	<u>\$ 178</u>	<u>\$ 107</u>	<u>\$(130)</u>	<u>\$(168)</u>

* Amortized over periods ranging from 3 to 22 years.

Plan assets consist primarily of listed stocks and bonds. Our Retirement Plan assets are allocated 80 percent to equities and 20 percent to fixed income investments. Our DPSP assets are allocated 60 percent to equities and 40 percent to fixed income investments. Allocation between equities and fixed income investments varies by plan in countries outside the U.S., but all plans' assets are broadly diversified both domestically and overseas.

As of October 31, 2002, all of our defined benefit plans had benefit obligations that were in excess of the fair value of the plan assets; at the end of 2001, four of our plans outside the U.S. did not have obligations in excess of assets. The amounts of the obligations and assets for the underfunded plans only were:

	U.S. Defined Benefit Plans October 31,		Non-U.S. Defined Benefit Plans October 31,	
	2002	2001	2002	2001
	(in millions)			
Aggregate projected benefit obligation (“PBO”)	\$(761)	\$(702)	\$(957)	\$(579)
Aggregate accumulated benefit obligation (“ABO”)	\$(432)	\$(374)	\$(736)	\$(464)
Aggregate fair value of plan assets	\$ 407	\$ 451	\$ 657	\$ 483

An additional minimum pension liability adjustment was required for our pension plans in Germany, Japan and the United Kingdom during 2002 as the accumulated benefit obligation of \$529 million for those plans exceeded the \$441 million of pension plan assets for those plans as of the measurement date. The \$88 million difference was increased by \$142 million for net prepaid pension costs for all of the affected plans and reduced by \$6 million for intangible assets in the United Kingdom's plan and one of the Japanese plans, resulting in a gross additional

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

minimum pension liability of \$224 million. Of this amount, \$146 million impacted accumulated comprehensive loss, offset by \$78 million applied to deferred tax assets.

Assumptions. The assumptions used to determine the benefit obligations and expense for our defined benefit and postretirement benefit plans are presented in the table below. The impacts of the assumptions listed for the years 2002, 2001 and 2000 have already been recognized in our consolidated statement of operations. The assumptions for the year 2003 were used to determine the obligations presented as of October 31, 2002 in the funded status table above, and their impacts will be recognized in our consolidated statements of operations during 2003.

	<u>Years Ended October 31,</u>			
	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>
U.S. defined benefit plans:				
Discount rate	6.75%	7.0%	7.5%	7.25%
Average increase in compensation levels	5.25%	5.5%	6.0%	5.0%
Expected long-term return on assets	8.75%	9.0%	9.0%	9.0%
Non-U.S. defined benefit plans:				
Discount rate	2.25 – 6.0%	2.5 – 6.5%	3.0 – 6.5%	3.3 – 6.0%
Average increase in compensation levels	3.5 – 4.25%	3.5 – 5.5%	3.5 – 5.5%	3.5 – 5.3%
Expected long-term return on assets	5.5 – 7.75%	6.5 – 8.5%	6.1 – 8.5%	6.1 – 8.5%
U.S. postretirement benefits plans:				
Discount rate	6.75%	7.0%	7.5%	7.25%
Expected long-term return on assets	8.75%	9.0%	9.0%	9.0%
Current medical cost trend rate	9.0%	7.75%	7.75%	8.2%
Ultimate medical cost trend rate	5.5%	5.5%	5.5%	5.5%
Medical cost trend rate decreases to ultimate rate in year	2007	2007	2007	2007

Assumed health care trend rates could have a significant effect on the amounts reported for health care plans. A 1 percentage point change in the assumed health care cost trend rates for the year ended October 31, 2003 would have the following effects:

	<u>1 Percentage Point Increase</u>	<u>1 Percentage Point Decrease</u>
	<u>(in millions)</u>	
Effect on total service and interest cost components	\$11	\$ (8)
Effect on postretirement benefit obligations	\$79	\$(63)

Annual Report Financials

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

16. Other Accrued Liabilities

Other accrued liabilities and other long-term liabilities at October 31, 2002 and 2001 were as follows:

	October 31,	
	2002	2001
	(in millions)	
Other accrued liabilities		
Accrued expenses	\$280	\$343
Restructuring	148	89
Warranty accruals	59	62
Lease guarantees	68	71
Other	19	17
Total other accrued liabilities	\$574	\$582
Other long-term liabilities		
Retirement plans	\$118	\$169
Deferred compensation	34	37
Self-insured health and welfare	30	32
Other	63	87
Total other long-term liabilities	\$245	\$325

17. Senior Convertible Debentures and Lines of Credit

Senior Convertible Debentures. On November 27, 2001, we completed a private offering of \$1.15 billion aggregate principal amount of 3 percent senior convertible debentures (the “debentures”) due 2021 and generated net proceeds of \$1.12 billion after deducting fees and expenses. A registration statement filed on behalf of certain holders of the debentures became effective on April 11, 2002. The debentures are convertible at any time into our common stock at an initial conversion price of \$32.22 per share, subject to adjustment (as defined in the related Indenture agreement dated November 27, 2001) and are redeemable at the company’s option beginning at any time on or after December 6, 2004. Holders of the debentures have the ability to require us to repurchase the debentures, in whole or in part, on specified dates in 2006, 2011 and 2016. Holders also have the right to require us to repurchase all or a portion of the outstanding debentures if the company undergoes a Fundamental Change (as defined in the Indenture agreement), at a price equal to 100 percent of the principal amount plus interest. The debentures bear interest at an annual rate of 3 percent, which is payable on June 1 and December 1 of each year beginning June 1, 2002. The interest rate will reset (as defined in the Indenture agreement) in June 2006, June 2011 and June 2016, but in no event will it be reset below 3 percent or above 5 percent per annum. To date there have been no adjustments to the conversion price of the debentures.

Lines of Credit. Effective November 1, 2002, we terminated our \$250 million five-year revolving credit facility that was due to expire on November 5, 2005 and did not extend the \$250 million 364-day revolving credit facility that expired on November 1, 2002. We did not have plans to use these credit facilities, and we believe that the costs of renewing and/or retaining these credit facilities outweighed their benefits. There were no balances outstanding under either facility at October 31, 2002 or October 31, 2001.

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

18. Commitments

Operating Lease Commitments. We lease certain real and personal property from unrelated third parties under non-cancelable operating leases. Future minimum lease payments under leases at October 31, 2002 were \$91 million for 2003, \$78 million for 2004, \$65 million for 2005, \$50 million for 2006, \$39 million for 2007 and \$84 million thereafter. Certain leases require us to pay property taxes, insurance and routine maintenance, and include escalation clauses. Rent expense was \$177 million in 2002, \$100 million in 2001 and \$69 million in 2000.

19. Contingencies

We are involved in lawsuits, claims, investigations and proceedings, including patent, commercial and environmental matters that arise in the ordinary course of business. There are no such matters pending that we expect to be material in relation to our business, consolidated financial condition, results of operations or cash flows.

20. Segment Information

Description of segments. We are a diversified technology company that provides enabling solutions to customers in markets within the communications, electronics, life sciences and chemical analysis industries.

We organize our business operations into three major groups – test and measurement, semiconductor products, and life sciences and chemical analysis – each of which comprises a reportable segment. The segments were determined based primarily on how management views and evaluates our operations. Other factors, including customer base, homogeneity of products, technology and delivery channels, were also considered in determining our reportable segments.

Our three reportable segments are:

- test and measurement, which provides standard and customized solutions that are used in the design, development, manufacture, installation, deployment and operation of electronic equipment and systems and communications networks and services. The test and measurement business includes three operating segments that have been aggregated based on the similarity of the nature of their products and services, their production processes, their class of customers, their distribution methods and their economic characteristics;
- semiconductor products, which provides semiconductor components, modules and assemblies for high performance communications systems; and
- life sciences and chemical analysis, which provides application-focused solutions that include instruments, software, consumables and services that enable customers to identify, quantify and analyze the physical and biological properties of substances and products.

Segment revenue and profit. The accounting policies used to derive reportable segment results are generally the same as those described in Note 2, “Summary of Significant Accounting Policies.” In 2000, internal revenue and earnings from continuing operations include transactions between segments that are intended to reflect an arm’s length transfer at the best price available for comparable external customers.

A significant portion of the segments’ expenses arise from shared services and infrastructure that we have historically provided to the segments in order to realize economies of scale and to efficiently use resources. These expenses include costs of centralized research and development, legal, accounting, employee benefits, real estate, insurance services, information technology

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

services, treasury and other corporate infrastructure expenses. These expenses are allocated to the segments and the allocations have been determined on a basis that we considered to be a reasonable reflection of the utilization of services provided to or benefits received by the segments. A different result might be arrived at for any segment if costs were specifically identified to each segment.

In 2002 management changed the methods by which corporate charges were allocated to the segments. This change impacted cost of goods and services, research and development and selling, general and administrative expenses and (loss) earnings from operations recorded by each of the segments. Depreciation for each segment is no longer presented separately to management and consequently it has been excluded from the disclosure below. Information provided with respect to prior periods has been restated to reflect these changes.

The following tables reflect the results of our reportable segments under our management reporting system. These results are not necessarily a depiction that is in conformity with accounting principles generally accepted in the U.S. The performance of each segment is measured based on several metrics, including (loss) earnings from operations. These results are used, in part, by management in evaluating the performance of, and in allocating resources to, each of the segments.

	<u>Test and Measurement</u>	<u>Semiconductor Products</u>	<u>Life Sciences and Chemical Analysis</u>	<u>Total Segments</u>
	(in millions)			
Year Ended October 31, 2002:				
Total net revenue	\$3,318	\$1,559	\$1,133	\$6,010
(Loss) earnings from operations	\$ (837)	\$ (68)	\$ 150	\$ (755)
Year Ended October 31, 2001:				
Total net revenue	\$5,432	\$1,850	\$1,114	\$8,396
(Loss) earnings from operations	\$ (120)	\$ (177)	\$ 91	\$ (206)
Year Ended October 31, 2000:				
External revenue	\$6,108	\$2,213	\$1,040	\$9,361
Internal revenue	<u>—</u>	<u>51</u>	<u>—</u>	<u>51</u>
Total net revenue	<u>\$6,108</u>	<u>\$2,264</u>	<u>\$1,040</u>	<u>\$9,412</u>
Earnings from operations	\$ 756	\$ 229	\$ 10	\$ 995

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Reconciliation to our reported results:

	<u>Years Ended October 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
	(in millions)		
Net revenue from continuing operations:			
Total reportable segments	\$ 6,010	\$8,396	\$9,412
Elimination of internal revenue	<u>—</u>	<u>—</u>	<u>(51)</u>
Total net revenue, as reported	<u>\$ 6,010</u>	<u>\$8,396</u>	<u>\$9,361</u>
(Loss) earnings from continuing operations before taxes:			
Total reportable segments' (loss) earnings from operations	\$ (755)	\$ (206)	\$ 995
Amortization of goodwill	(326)	(303)	(64)
Amortization of intangibles	(52)	(41)	(7)
Restructuring and asset impairment	(474)	(154)	—
Capitalized software write-off	—	(74)	—
Other asset impairment	13	—	—
Retirement plans curtailment gain	(19)	—	—
Other	6	—	—
Other income (expense), net	<u>60</u>	<u>301</u>	<u>94</u>
(Loss) earnings from continuing operations before taxes, as reported	<u>\$(1,547)</u>	<u>\$ (477)</u>	<u>\$1,018</u>
Depreciation and amortization expense:			
Total reportable segments' depreciation	\$ 357	\$ 380	\$ 389
Corporate amortization expense	<u>378</u>	<u>354</u>	<u>71</u>
Total depreciation and amortization expense, as reported	<u>\$ 735</u>	<u>\$ 734</u>	<u>\$ 460</u>

Annual
Report
Financials

AGILENT TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Major Customers. No customer represented 10 percent or more of our total net revenue in 2002, 2001 or 2000.

The equity investment totals disclosed for each segment represent equity method investments directly managed by the segment.

	<u>Test and Measurement</u>	<u>Semiconductor Products</u>	<u>Life Sciences and Chemical Analysis</u>	<u>Total Segments</u>
	(in millions)			
As of October 31, 2002:				
Assets	\$5,509	\$1,735	\$959	\$8,203
Capital expenditures	\$ 195	\$ 68	\$ 38	\$ 301
Investment in equity-method investees....	\$ 22	\$ (21)	\$ –	\$ 1
As of October 31, 2001:				
Assets	\$5,310	\$1,714	\$962	\$7,986
Capital expenditures	\$ 495	\$ 304	\$ 82	\$ 881
Investment in equity-method investees....	\$ 21	\$ 14	\$ –	\$ 35
As of October 31, 2000:				
Assets	\$4,924	\$1,904	\$804	\$7,632
Capital expenditures	\$ 553	\$ 203	\$ 47	\$ 803
Investment in equity-method investees....	\$ 16	\$ 46	\$ 20	\$ 82

Total segment assets at October 31, 2000 excluded \$698 million of assets allocated to the healthcare solutions business which were determined under our management reporting system. Net investment in discontinued operations at October 31, 2000 of \$597 million was determined using accounting principles generally accepted in the U.S.

Geographic Information

	<u>United States</u>	<u>Japan</u>	<u>Rest of the World</u>	<u>Total</u>
	(in millions)			
Net revenue (based on location of customer):				
Year ended October 31, 2002	\$2,355	\$ 597	\$3,058	\$6,010
Year ended October 31, 2001	\$3,373	\$1,083	\$3,940	\$8,396
Year ended October 31, 2000	\$3,992	\$1,032	\$4,337	\$9,361
Long-lived assets (all non-current assets):				
October 31, 2002	\$1,250	\$ 434	\$1,639	\$3,323
October 31, 2001	\$1,796	\$ 539	\$ 852	\$3,187
October 31, 2000	\$1,316	\$ 356	\$ 922	\$2,594

QUARTERLY SUMMARY
(Unaudited)

	Three Months Ended			
	January 31	April 30	July 31	October 31
	(in millions, except per share amounts)			
2002	(1)	(2)	(3)	(4)
Net revenue	\$ 1,426	\$ 1,457	\$ 1,391	\$ 1,736
Cost of products and services and other	\$ 878	\$ 854	\$ 846	\$ 1,116
Loss from operations	\$ (442)	\$ (349)	\$ (429)	\$ (387)
Loss from continuing operations	\$ (317)	\$ (247)	\$ (223)	\$ (235)
Gain (loss) from sale of discontinued operations, net of taxes	2	(6)	(5)	(1)
Net loss	<u>\$ (315)</u>	<u>\$ (253)</u>	<u>\$ (228)</u>	<u>\$ (236)</u>
Net loss per share – Basic and Diluted:				
Net loss from continuing operations	\$ (0.68)	\$ (0.54)	\$ (0.48)	\$ (0.51)
Loss from sale of discontinued operations, net of taxes	–	(0.01)	(0.01)	–
Net loss	<u>\$ (0.68)</u>	<u>\$ (0.55)</u>	<u>\$ (0.49)</u>	<u>\$ (0.51)</u>
Weighted average shares used in computing net loss per share:				
Basic and Diluted	463	464	466	467
Range of closing stock prices on NYSE	\$22.06-33.30	\$24.83-38.00	\$16.00-31.25	\$10.50-18.88
2001	(5)	(6)	(7)	(8)
Net revenue	\$ 2,565	\$ 2,406	\$ 1,819	\$ 1,606
Cost of products and services and other	\$ 1,222	\$ 1,353	\$ 1,075	\$ 1,240
Earnings (loss) from operations	\$ 294	\$ (49)	\$ (331)	\$ (692)
Earnings (loss) from continuing operations	\$ 174	\$ 89	\$ (220)	\$ (449)
Net earnings (loss) from discontinued operations	(2)	13	(5)	–
Gain from sale of discontinued operations, net of taxes	–	–	–	646
Net earnings (loss) before cumulative effect of accounting changes	172	102	(225)	197
Cumulative effect of adopting SFAS No 133, net of taxes	(25)	–	–	–
Cumulative effect of adopting SAB 101, net of taxes ..	(47)	–	–	–
Net earnings (loss)	<u>\$ 100</u>	<u>\$ 102</u>	<u>\$ (225)</u>	<u>\$ 197</u>
Net earnings (loss) per share – Basic:				
Net earnings (loss) from continuing operations	\$ 0.38	\$ 0.19	\$ (0.48)	\$ (0.98)
Net earnings (loss) from discontinued operations	–	0.03	(0.01)	–
Gain from sale of discontinued operations, net of taxes	–	–	–	1.41
Cumulative effect of adopting SFAS No. 133, net of taxes	(0.06)	–	–	–
Cumulative effect of adopting SAB 101, net of taxes ..	(0.10)	–	–	–
Net earnings (loss)	<u>\$ 0.22</u>	<u>\$ 0.22</u>	<u>\$ (0.49)</u>	<u>\$ 0.43</u>
Net earnings (loss) per share – Diluted:				
Net earnings (loss) from continuing operations	\$ 0.37	\$ 0.19	\$ (0.48)	\$ (0.98)
Net earnings (loss) from discontinued operations	–	0.03	(0.01)	–
Gain from sale of discontinued operations, net of taxes	–	–	–	1.41
Cumulative effect of adopting SFAS No. 133, net of taxes	(0.06)	–	–	–
Cumulative effect of adopting SAB 101, net of taxes ..	(0.10)	–	–	–
Net earnings (loss)	<u>\$ 0.21</u>	<u>\$ 0.22</u>	<u>\$ (0.49)</u>	<u>\$ 0.43</u>

	Three Months Ended			
	January 31	April 30	July 31	October 31
	(in millions, except per share amounts)			
Weighted average shares used in computing net earnings (loss) per share:				
Basic	455	456	459	460
Diluted	466	461	459	460
Range of closing stock prices on NYSE	\$38.06-68.00	\$25.00-55.00	\$26.20-41.18	\$18.00-32.70

NOTES:

- (1) Includes pre-tax restructuring and asset impairment charges of \$105 million primarily relating to severance expenses
- (2) Includes pre-tax restructuring and asset impairment charges of \$35 million primarily relating to severance expenses
- (3) Includes pre-tax restructuring and asset impairment charges of \$78 million primarily relating to severance expenses
- (4) Includes pre-tax severance and other restructuring charges of \$133 million and pre-tax asset impairment charges of \$123 million
- (5) Includes pre-tax inventory charges of \$30 million
- (6) Includes pre-tax gains of \$269 million relating to the sale of surplus land in California and pre-tax inventory charges of \$143 million
- (7) Includes pre-tax capitalized software write-off of \$74 million and pre-tax inventory charges of \$99 million
- (8) Includes pre-tax restructuring charges of \$154 million primarily relating to severance expenses and pre-tax inventory charges of \$187 million

**DIRECTIONS TO
THE SOUTH SAN FRANCISCO
CONFERENCE CENTER**

FROM SAN JOSE

Take Highway 101 North to the South Airport Boulevard exit.

At the first stop light; drive straight across the intersection and directly into the Holiday Inn parking lot.

The South San Francisco Conference Center is on the left.

FROM SAN FRANCISCO

Take Highway 101 South to the South Airport Boulevard exit in South San Francisco.

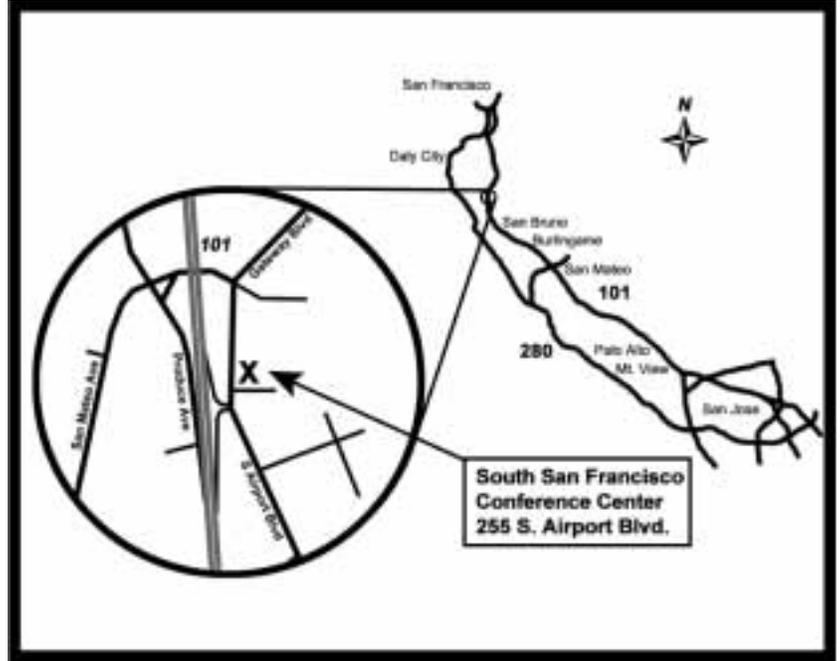
Stay to the right and turn east under the freeway overpass.

Make a right, at the Hungry Hunter Restaurant, onto South Airport Boulevard.

The South San Francisco Conference Center is located on the left between the Ramada Inn and the Holiday Inn.

PARKING

The South San Francisco Conference Center has an agreement to share parking with both neighboring hotels – the Holiday Inn to the south and the Ramada Inn to the north. Additional parking is available diagonally across the street in the lot located between the Travelodge and the Best Western Grosvenor Hotel.



© Agilent Technologies, Inc.

Printed in U.S.A. January, 2003

♻️ Printed on recycled paper with 30% post-consumer waste



Agilent Technologies

Annual Meeting of Stockholders
The South San Francisco Conference Center
255 South Airport Boulevard
South San Francisco, California
March 4, 2003 at 10 a.m.

ADMIT ONE



Agilent Technologies

Annual Meeting of Stockholders
The South San Francisco Conference Center
255 South Airport Boulevard
South San Francisco, California
March 4, 2003 at 10 a.m.

ADMIT ONE