AGILENT TECHNOLOGIES INC
Form 10-Q
September 06, 2006

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

x	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**
	FOR THE QUARTERLY PERIOD ENDED JULY 31, 2006
	OR
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**
	FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER: 001-15405

AGILENT TECHNOLOGIES, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE (STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	**77-0518772** (IRS EMPLOYER IDENTIFICATION NO.)
395 PAGE MILL ROAD, PALO ALTO, CALIFORNIA (ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	**94306** (ZIP CODE)

REGISTRANT S TELEPHONE NUMBER, INCLUDING AREA CODE **(650) 752-5000**

(FORMER NAME, FORMER ADDRESS AND FORMER FISCAL YEAR, IF CHANGED SINCE LAST REPORT)

INDICATE BY CHECK MARK WHETHER THE REGISTRANT (1) HAS FILED ALL REPORTS REQUIRED TO BE FILED BY SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 DURING THE PRECEDING 12 MONTHS (OR FOR SUCH SHORTER PERIOD THAT THE REGISTRANT WAS REQUIRED TO FILE SUCH REPORTS), AND (2) HAS BEEN SUBJECT TO SUCH FILING REQUIREMENTS FOR THE PAST 90 DAYS. YES x NO o

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A LARGE ACCELERATED FILER, AN ACCELERATED FILER, OR NON-ACCELERATED FILER. SEE DEFINITION OF ACCELERATED FILER AND LARGE ACCELERATED FILER IN RULE 12b-2 OF THE EXCHANGE ACT. (CHECK ONE):

LARGE ACCELERATED FILER x ACCELERATED FILER o NON-ACCELERATED FILER o

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A SHELL COMPANY (AS DEFINED IN RULE 12b-2 OF THE EXCHANGE ACT). YES o NO x

INDICATE THE NUMBER OF SHARES OUTSTANDING OF EACH OF THE ISSUER S CLASSES OF COMMON STOCK, AS OF THE LATEST PRACTICABLE DATE.

CLASS	OUTSTANDING JULY 31, 2006
COMMON STOCK, $0.01 PAR VALUE	**408,679,323 SHARES**

AGILENT TECHNOLOGIES, INC.
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PART I FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

AGILENT TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS

(in millions, except per share amounts)

(Unaudited)

	Three Months Ended July 31, 2006	2005	Nine Months Ended July 31, 2006	2005
Net revenue:				
Products	$ 1,208	$ 1,015	$ 3,502	$ 3,040
Services and other	245	227	718	692
Total net revenue	1,453	1,242	4,220	3,732
Costs and expenses:				
Cost of products	511	502	1,564	1,477
Cost of services and other	151	144	454	428
Total costs	662	646	2,018	1,905
Research and development	186	183	572	547
Selling, general and administrative	463	378	1,387	1,165
Gain on sale of Palo Alto headquarters and San Jose site	(65)		(121)	
Total costs and expenses	1,246	1,207	3,856	3,617
Income from operations	207	35	364	115
Other income (expense), net	44	25	139	60
Income from continuing operations before taxes and equity income	251	60	503	175
Provision for income taxes	18	19	61	53
Equity in net income of unconsolidated affiliate and gain on sale - Lumileds		13	901	36
Income from continuing operations	233	54	1,343	158
Income from and gain (loss) on sale of discontinued operations, net	(6)	50	1,815	144
Net income	$ 227	$ 104	$ 3,158	$ 302
Net income per share basic:				
Income from continuing operations	$ 0.57	$ 0.11	$ 3.07	$ 0.32
Income from and gain (loss) on sale of discontinued operations, net	(0.02)	0.10	4.14	0.29
Net income per share basic	$ 0.55	$ 0.21	$ 7.21	$ 0.61
Net income per share diluted:				
Income from continuing operations	$ 0.55	$ 0.10	$ 2.99	$ 0.32
Income from and gain (loss) on sale of discontinued operations, net	(0.01)	0.10	4.04	0.29
Net income per share diluted	$ 0.54	$ 0.20	$ 7.03	$ 0.61
Weighted average shares used in computing net income per share:				
Basic	412	494	438	492
Diluted	422	499	449	497

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

AGILENT TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEET

(in millions, except par value and share amounts)

(Unaudited)

	July 31, 2006	October 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,249	$ 2,226
Short-term investments		25
Accounts receivable, net	853	753
Inventory	705	722
Other current assets	412	298
Current assets of discontinued operations		423
Total current assets	4,219	4,447
Property, plant and equipment, net	822	873
Goodwill and other intangible assets, net	481	362
Other assets	602	628
Restricted cash and cash equivalents	1,605	22
Non-current assets of discontinued operations		419
Total assets	$ 7,729	$ 6,751
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 425	$ 344
Employee compensation and benefits	422	542
Deferred revenue	292	247
Income and other taxes payable	381	474
Other accrued liabilities	159	179
Current liabilities of discontinued operations		150
Total current liabilities	1,679	1,936
Long-term debt	1,500	
Retirement and post-retirement benefits	266	383
Other long-term liabilities	492	351
Total liabilities	3,937	2,670
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; 534 million shares at July 31, 2006 and 512 million shares at October 31, 2005 issued	5	5
Treasury stock at cost; 125 million shares at July 31, 2006 and 9 million shares at October 31, 2005	(4,469)	(290)
Additional paid-in-capital	6,543	5,878
Retained earnings (accumulated deficit)	1,695	(1,463)
Accumulated other comprehensive income (loss)	18	(49)
Total stockholders equity	3,792	4,081
Total liabilities and stockholders equity	$ 7,729	$ 6,751

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

AGILENT TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(in millions) (Unaudited)

	Nine Months Ended July 31, 2006	2005
Cash flows from operating activities:		
Net income	$ 3,158	$ 302
Less: income from and gain on sale of discontinued operations, net	1,815	144
Income from continuing operations	1,343	158
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:		
Depreciation and amortization	134	141
Deferred taxes	(9)	31
Excess and obsolete inventory-related charges	44	48
Asset impairment charges	26	13
Net gain on sale of investments	(9)	(16)
Gain on sale and undistributed equity in net income of Lumileds	(901)	(36)
Net gain on sale of assets	(111)	(4)
Share-based compensation	82	4
Net pension curtailment and settlement gains	(28)	
In-process research and development	2	1
Changes in assets and liabilities:		
Accounts receivable	(90)	24
Inventory	(27)	11
Accounts payable	89	(26)
Employee compensation and benefits	(119)	(78)
Income taxes and other taxes payable	(80)	(28)
Other current assets and liabilities	(23)	(14)
Other long-term assets and liabilities	(97)	62
Net cash provided by operating activities of continuing operations	226	291
Net cash provided by operating activities of discontinued operations	7	189
Net cash provided by operating activities	233	480
Cash flows from investing activities:		
Investments in property, plant and equipment	(165)	(112)
Proceeds from sale of property, plant and equipment	205	45
Investments in equity securities	(5)	(11)
Proceeds from the sale of Lumileds and other investments	966	22
Net proceeds from sale of discontinued operations	2,509	
Increase in restricted cash, cash equivalents and investments, net	(1,583)	(20)
Payment of loan receivable	50	6
Proceeds from sale of short-term investments	25	
Purchase of minority interest, primarily Yokogawa Analytical Systems	(104)	
Acquisitions of businesses and intangible assets, net of cash acquired	(30)	(47)
Net cash provided by (used in) investing activities of continuing operations	1,868	(117)
Net cash used in investing activities of discontinued operations	(6)	(5)
Net cash provided by (used in) investing activities	1,862	(122)
Cash flows from financing activities:		
Issuance of common stock under employee stock plans	513	115
Treasury stock repurchases	(4,179)	
Net proceeds from sale of subsidiary stock (Verigy)	121	
Proceeds from term-facility	700	
Repayment of term facility	(700)	
Cash distribution to minority interest in consolidated joint venture	(16)	
Net borrowings of notes payable and short-term borrowings		(3)
Debt issuance costs	(25)	
Long-term debt	1,500	
Net cash provided by (used in) financing activities	(2,086)	112
Effect of exchange rate movements	14	(3)

Net increase in cash and cash equivalents	23	467
Cash and cash equivalents at beginning of period	2,226	2,315
Cash and cash equivalents at end of period	$ 2,249	$ 2,782

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

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AGILENT TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. OVERVIEW

Agilent Technologies, Inc. (we , Agilent or the company), incorporated in Delaware in May 1999, is a measurement company, providing core bio-analytical and electronic measurement solutions to the communications, electronics, life sciences and chemical analysis industries.

In the first quarter of 2006, we completed the divestiture of our semiconductor products business. The results of our semiconductor products business are presented as a discontinued operation for all periods in the condensed consolidated financial statements included herein. See Note 4, Discontinued Operations. In the third quarter of 2006, we completed the initial public offering of our semiconductor test solutions business, Verigy Ltd., (Verigy). Verigy is a majority-owned subsidiary of Agilent and its results of operations and financial position will be consolidated in our financial statements until the expected distribution of our remaining shares in Verigy. For further information, see Note 19, Separation of Our Semiconductor Test Solutions Business, Verigy Ltd.

Our fiscal year end is October 31, and our fiscal quarters end on January 31, April 30 and July 31. Unless otherwise stated, all dates refer to our fiscal year and fiscal periods.

2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reclassifications. Restricted cash and cash equivalents in the condensed consolidated balance sheet as of October 31, 2005 have been reclassified to conform to the current period s presentation. Equity in net income of unconsolidated affiliate and gain on sale Lumileds in the condensed consolidated statement of operations and condensed consolidated statement of cash flows for the periods ended July 31, 2005 have been reclassified to conform to the current period s presentation.

Basis of Presentation. We have prepared the accompanying financial data for the three and nine months ended July 31, 2006 and 2005 pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles (GAAP) in the U.S. have been condensed or omitted pursuant to such rules and regulations. The following discussion should be read in conjunction with our 2005 Annual Report on Form 10-K.

In the opinion of management, the accompanying condensed consolidated financial statements contain all normal and recurring adjustments necessary to present fairly our condensed consolidated balance sheet as of July 31, 2006 and October 31, 2005, condensed consolidated statement of operations for the three and nine months ended July 31, 2006 and 2005, and condensed consolidated statement of cash flows for the nine months ended July 31, 2006 and 2005.

The preparation of condensed consolidated financial statements in conformity with GAAP in the U.S. requires management to make estimates, judgments and assumptions that affect the amounts reported in our condensed consolidated financial statements and accompanying notes. Our critical accounting policies are those that affect our financial statements materially and involve difficult, subjective or complex judgments by management. Those policies are revenue recognition, restructuring and asset impairment charges, inventory valuation, investment and asset impairments, share-based compensation, retirement and post retirement benefit plan assumptions, valuation of long-lived assets and accounting for income taxes. 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.

3. NEW ACCOUNTING PRONOUNCEMENTS

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards, No.123 (revised 2004), Share-Based Payment (SFAS No. 123 (R)), which requires the measurement and recognition of compensation expense based on estimated fair value for all share-based payment awards including stock options, employee stock purchases under employee stock purchase plans, non-vested share awards (restricted stock) and stock appreciation rights. SFAS No. 123 (R) supersedes our previous accounting under

Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB No. 25). In March 2005, the SEC issued Staff Accounting Bulletin (SAB) No. 107, which provides the Staff s views regarding implementation issues related to SFAS No. 123 (R).

We adopted the provisions of SFAS No. 123 (R) using the modified prospective transition method beginning November 1, 2005, the first day of the first quarter of fiscal 2006. In accordance with that transition method, we have not restated prior periods for the effect of compensation expense calculated under SFAS No. 123 (R). We have selected the Black-Scholes option-pricing model as the most appropriate method for determining the estimated fair value of all our awards, except for the non-vested performance shares under the Long Term Performance Program (LTPP). For the LTPP, we are using a Monte Carlo simulation to estimate grant date

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fair value as required by SFAS No. 123 (R). Compensation expense for all share-based equity awards issued after November 1, 2005 is being recognized on a straight-line basis over the vesting period of the award. For awards issued prior to November 1, 2005, we are recognizing compensation expense based on the accelerated method described in FASB Interpretation No. 28 Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans (FIN 28). The adoption of SFAS No. 123 (R) also requires additional accounting related to income taxes and earnings per share as well as additional disclosure related to the cash flow effects resulting from share-based compensation. The adoption of SFAS No. 123 (R) had a material impact on our condensed consolidated financial statements for the three and nine months ended July 31, 2006, and is expected to continue to materially impact our financial statements in the foreseeable future. See Note 6, Share-Based Compensation for more information on the impact of the new standard.

In November 2005, the FASB issued FASB Staff Position (FSP) SFAS No. 123 (R)-3, Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards, (FSP SFAS No. 123 (R)-3). FSP SFAS No. 123 (R)-3 provides a practical exception when a company transitions to the accounting requirements in SFAS No. 123 (R). SFAS No. 123 (R) requires a company to calculate the pool of excess tax benefits available to absorb tax deficiencies recognized subsequent to adopting SFAS No. 123 (R) (termed the APIC Pool), assuming the company had been following the recognition provisions prescribed by SFAS No. 123. We have elected to use the guidance in FSP SFAS No. 123 (R)-3 to calculate our APIC Pool. FSP SFAS No. 123 (R)-3 was effective immediately. The adoption of the FSP did not have an impact on our overall results of operations or financial position.

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Income Tax Uncertainties (FIN 48). FIN 48 defines the threshold for recognizing the benefits of tax return positions in the financial statements as more-likely-than-not to be sustained by the taxing authority and provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties. FIN 48 also includes guidance concerning accounting for income tax uncertainties in interim periods and increases the level of disclosures associated with any recorded income tax uncertainties. FIN 48 is effective for fiscal years beginning after December 15, 2006. The differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption will be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. We have not yet determined the impact, if any, of adopting the provisions of FIN 48 on our financial position, results of operations and liquidity.

In June 2006, the FASB issued Emerging Issues Tax Force (EITF) Issue No. 06-3, How Sales Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation), (EITF 06-3). EITF 06-3 requires disclosure of accounting policy regarding the gross or net presentation of point-of-sales taxes such as sales tax and value-added tax. If taxes included in gross revenues are significant, the amount of such taxes for each period for which an income statement is presented should also be disclosed. EITF 06-3 will be effective for the first annual or interim reporting period after December 15, 2006. We will be adopting this pronouncement beginning in the first quarter of fiscal year 2007, and we have not yet determined the financial statement or related disclosure impact, if any.

4. DISCONTINUED OPERATIONS

On December 1, 2005, we completed the divestiture of our semiconductor products business to Avago Technologies Ltd. (Avago). Under the terms of the Asset Purchase Agreement (APA), Agilent received approximately $2,559 million in cash proceeds, subject to further adjustment based on transfer taxes and other items as defined in the APA.

The following table shows the components of the estimated gain from sale of discontinued operations, net of taxes as of July 31, 2006:

	(in millions)
Proceeds, net of working capital adjustments	$ 2,559
Book value of net assets disposed of	(707)
Costs of disposition	(35)
Gain on sale of discontinued operations	1,817
Income taxes	8
Gain on sale of discontinued operations, net	$ 1,809

In the three months ended April 30, 2006 and July 31, 2006, we adjusted the gain on sale of discontinued operations by $22 million which includes $20 million for working capital adjustments and $2 million for the disposal of fixed assets. The $35 million costs of disposition include a gain of $51 million for pension curtailments and settlements. The tax impact of the sale of our semiconductor products business reflects the utilization of the valuation allowance within the U.S. and a low effective tax rate in other jurisdictions.

Our condensed consolidated financial statements reflect our semiconductor products business as a discontinued operation in accordance with SFAS No.144, Accounting for the Impairment or Disposal of Long-Lived Assets.

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The following table summarizes results from discontinued operations for the periods ended July 31, 2006 and July 31, 2005 included in the condensed consolidated statement of operations:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2006 (in millions)	2005	2006 (in millions)	2005
Net revenue	$	$ 446	$ 141	$ 1,302
Costs, expenses and other income (expense), net		(390)	(133)	(1,140)
Income from discontinued operations	$	$ 56	$ 8	$ 162
Gain (loss) on sale of discontinued operations	(6)		1,817	
Income from and gain (loss) on sale of discontinued operations before taxes	(6)	56	1,825	$ 162
Provision for income taxes		6	10	18
Income from and gain (loss) on sale of discontinued operations, net	$ (6)	$ 50	$ 1,815	$ 144

The following table presents Agilent s semiconductor products business s estimated book value of net assets disposed of:

	As of November 30, 2005 (in millions)
Assets:	
Cash	$ 4
Accounts receivable, net	219
Inventory	185
Other current assets	21
Current assets of discontinued operations	429
Property, plant and equipment, net	277
Goodwill and other intangible assets, net	98
Other assets	53
Non-current assets of discontinued operations	428
Total assets of discontinued operations	$ 857
Liabilities:	
Accounts payable	$ 115
Employee compensation and benefits	17
Other current liabilities	11
Current liabilities of discontinued operations	143
Other long term liabilities	7
Long term liabilities of discontinued operations	7
Total liabilities of discontinued operations	$ 150
Book value of net assets disposed of	$ 707

In accordance with SFAS No. 142 Goodwill and other Intangibles (SFAS No. 142), approximately $98 million of goodwill associated with the semiconductor products business was eliminated and recorded as an adjustment to the gain on sale of discontinued operations.

Indemnifications to Avago

In connection with the sale of our semiconductor products business in December 2005, we agreed to indemnify Avago, its affiliates and other related parties against damages that it might incur in the future. These indemnifications primarily cover damages relating to liabilities of the businesses that Agilent retained and did not transfer to Avago, as well as pre-closing taxes and other specified items. Agilent s indemnification for representations and warranties made to Avago are generally limited to 10 percent of the purchase price and survive until March 31, 2007.

5. NET INCOME PER SHARE

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

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	Three Months Ended July 31,		Nine Months Ended July 31,	
	2006	2005	2006	2005
	(in millions)			
Numerator:				
Income from continuing operations				