AGILENT TECHNOLOGIES INC
Form 10-Q
September 06, 2013
Table of Contents

UNITED STATES
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, 2013
OR
¨ 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	77-0518772
(State or other jurisdiction of incorporation or organization)	(IRS employer Identification no.)
5301 STEVENS CREEK BLVD., SANTA CLARA, CALIFORNIA	95051
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (408) 345-8886
(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 ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the exchange act.

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ 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 AT JULY 31, 2013

COMMON STOCK, $0.01 PAR VALUE	330,791,981

Table of Contents

AGILENT TECHNOLOGIES, INC.
TABLE OF CONTENTS

Table of Contents

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,		Nine Months Ended July 31,	
	2013	2012	2013	2012
Net revenue:				
Products	$1,335	$1,428	$4,139	$4,205
Services and other	317	295	925	886
Total net revenue	1,652	1,723	5,064	5,091
Costs and expenses:				
Cost of products	625	676	1,936	1,927
Cost of services and other	171	157	501	482
Total costs	796	833	2,437	2,409
Research and development	171	162	531	490
Selling, general and administrative	449	458	1,430	1,351
Total costs and expenses	1,416	1,453	4,398	4,250
Income from operations	236	270	666	841
Interest income	2	2	5	7
Interest expense	(27)	(24)	(77)	(75)
Other income (expense), net	1	(10)	11	14
Income before taxes	212	238	605	787
Provision (benefit) for income taxes	44	(5)	92	59
Net income	$168	$243	$513	$728
Net income per share:				
Basic	$0.50	$0.70	$1.49	$2.09
Diluted	$0.49	$0.69	$1.47	$2.06
Weighted average shares used in computing net income per share:				
Basic	339	348	344	348
Diluted	343	353	348	353
Cash dividends declared per common share	$0.12	$0.10	$0.34	$0.20

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

Table of Contents

AGILENT TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(in millions)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	July 31,		July 31,	
	2013	2012	2013	2012
Net income	$168	$243	$513	$728
Other comprehensive income (loss):				
Change in unrealized gain on investments, net of tax expense (benefit) of $1, $0, $2 and $(8)	4	—	5	6
Change in unrealized gain on derivative instruments, net of tax expense (benefit) of $(3), $0, $2 and $2	(4)	(2)	7	2
Amounts reclassified into earnings related to derivative instruments, net of tax benefit of $(1), $(1), $(3) and $(2)	(3)	—	(8)	(4)
Foreign currency translation	(32)	(102)	(87)	(160)
Net defined benefit pension cost and post retirement plan costs:				
Change in actuarial net loss, net of tax expense of $6, $3, $16 and $9	15	13	45	41
Change in net prior service benefit, net of tax benefit of $(4), $0, $(12) and $0	(8)	(12)	(24)	(36)
Other comprehensive loss	(28)	(103)	(62)	(151)
Total comprehensive income	$140	$140	$451	$577

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

Table of Contents

AGILENT TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEET
(in millions, except par value and share amounts)
(Unaudited)

	July 31, 2013	October 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$2,330	$2,351
Accounts receivable, net	875	923
Inventory	1,054	1,014
Other current assets	325	341
Total current assets	4,584	4,629
Property, plant and equipment, net	1,139	1,164
Goodwill	2,995	3,025
Other intangible assets, net	945	1,086
Long-term investments	124	109
Other assets	491	523
Total assets	$10,278	$10,536
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$407	$461
Employee compensation and benefits	345	387
Deferred revenue	463	420
Short-term debt	—	250
Other accrued liabilities	335	375
Total current liabilities	1,550	1,893
Long-term debt	2,701	2,112
Retirement and post-retirement benefits	463	554
Other long-term liabilities	774	792
Total liabilities	5,488	5,351
Commitments and contingencies (Note 12)		
Total equity:		
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; 600 million shares at July 31, 2013 and 595 million shares at October 31, 2012 issued	6	6
Treasury stock at cost; 269 million shares at July 31, 2013 and 249 million shares at October 31, 2012	(9,607)	(8,707)
Additional paid-in-capital	8,660	8,489
Retained earnings	5,901	5,505
Accumulated other comprehensive loss	(173)	(111)
Total stockholders' equity	4,787	5,182
Non-controlling interest	3	3
Total equity	4,790	5,185
Total liabilities and equity	$10,278	$10,536

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

Table of Contents

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

	Nine Months Ended July 31,	
	2013	2012
Cash flows from operating activities:		
Net income	$513	$728
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	277	207
Share-based compensation	66	59
Excess tax benefit from share-based plans	(2)	—
Deferred taxes	1	2
Excess and obsolete inventory and inventory-related charges	36	20
Other non-cash expenses, net	8	2
Changes in assets and liabilities:		
Accounts receivable	31	(22)
Inventory	(81)	(74)
Accounts payable	(47)	(1)
Employee compensation and benefits	(37)	(105)
Other assets and liabilities	10	(73)
Net cash provided by operating activities	775	743
Cash flows from investing activities:		
Investments in property, plant and equipment	(163)	(132)
Proceeds from lease receivable	—	80
Proceeds from sale of property, plant and equipment	2	—
Payment to acquire equity method investment	(21)	—
Purchase of other investments	(15)	—
Proceeds from sale of investments	11	5
Acquisitions of businesses and intangible assets, net of cash acquired	(11)	(2,227)
Net cash used in investing activities	(197)	(2,274)
Cash flows from financing activities:		
Issuance of common stock under employee stock plans	116	90
Payment of dividends	(117)	(70)
Purchase of non-controlling interest	(3)	(6)
Excess tax benefit from share-based plans	2	—
Issuance of senior notes	597	—
Debt issuance costs	(5)	—
Repayment of senior notes	(250)	—
Repayment of credit facility	—	(1)
Treasury stock repurchases	(900)	(78)
Net cash used in financing activities	(560)	(65)
Effect of exchange rate movements	(39)	(8)

Net decrease in cash and cash equivalents	(21)	(1,604)
Cash and cash equivalents at beginning of period	2,351	3,527
Cash and cash equivalents at end of period	$2,330	$1,923

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

Table of Contents

AGILENT TECHNOLOGIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. OVERVIEW, BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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 life sciences, chemical analysis, diagnostics and genomics, communications and electronics industries.

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 quarters.

Acquisition of Dako A/S. On June 21, 2012, we completed the acquisition of Dako A/S through the acquisition of 100% of the share capital of Dako A/S, a limited liability company incorporated under the laws of Denmark (“Dako”), under the share purchase agreement dated May 16, 2012. As a result of the acquisition, Dako has become a wholly-owned subsidiary of Agilent. The consideration paid was approximately $2,143 million, of which $1,400 million was paid directly to the seller and $743 million was paid to satisfy the outstanding debt of Dako. Agilent funded the acquisition using existing cash. The results of Dako are included in Agilent's condensed consolidated financial statements from the date of acquisition.

Acquisition and integration costs directly related to the Dako acquisition totaled $4 million and $9 million for the three and nine months ended July 31, 2013, respectively and were $13 million in both the three and nine months ended July 31, 2012. These costs were recorded in selling, general and administrative expenses and were expensed in accordance with the authoritative accounting guidance.

The following represents pro forma operating results as if Dako had been included in the company's condensed consolidated statements of operations as of the beginning of fiscal 2011(in millions, except per share amounts):

	Three Months Ended July 31, 2012	Nine Months Ended
Net revenue	$1,783	$5,333
Net income	$252	$707
Net income per share - basic	$0.72	$2.03
Net income per share - diluted	$0.71	$2.00

The pro forma financial information assumes that the companies were combined as of November 1, 2010 and include business combination accounting effects from the acquisition including amortization charges from acquired intangible assets, the impact on cost of sales due to the respective estimated fair value adjustments to inventory, changes to interest income for cash used in the acquisition, interest expense and currency losses associated with debt paid in connection with the acquisition and acquisition related transaction costs and tax related effects. The pro forma information as presented above is for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisition had taken place at the beginning of fiscal 2011.

The unaudited pro forma financial information for the three months ended July 31, 2012 combines the historical results of Agilent for the three months ended July 31, 2012 (which includes Dako from the acquisition date) and for Dako for the two months ended May 31, 2012. The unaudited pro forma financial information for the nine months ended July 31, 2012 combines the historical results of Agilent for the nine months ended July 31, 2012 (which includes Dako from the acquisition date) and for Dako for the six months ended March 31, 2012 and the two months ended May 31, 2012.

Basis of Presentation. We have prepared the accompanying financial data for the three and nine months ended July 31, 2013 and 2012 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 accompanying financial data and information should be read in conjunction with our Annual Report on Form 10-K.

Table of Contents

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, 2013 and October 31, 2012, condensed consolidated statement of comprehensive income for the three and nine months ended July 31, 2013 and 2012, condensed consolidated statement of operations for the three and nine months ended July 31, 2013 and 2012, and condensed consolidated statement of cash flows for the nine months ended July 31, 2013 and 2012.

The preparation of condensed consolidated financial statements in accordance with GAAP in the U.S. requires management to make estimates and assumptions that affect the amounts reported in our condensed 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. 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, inventory valuation, restructuring, share-based compensation, retirement and post-retirement benefit plan assumptions, goodwill and purchased intangible assets and accounting for income taxes.

In the third quarter of 2012, we formed a new operating segment. The new diagnostics and genomics segment was formed from a portion of our pre-existing life sciences business plus the business of the acquisition of Dako. Following this reorganization, Agilent has four business segments comprised of the life sciences business, the chemical analysis business, the diagnostics and genomics business and the electronic measurement business. The historical segment numbers for both life sciences and diagnostics and genomics segments have been recast to conform to this new reporting structure in our financial statements

Revision. The statement of cash flows for the nine months ended July 31, 2012 has been revised to correct the presentation of the purchase of non-controlling interest from investing to financing activities and is not considered material. There was no impact on previously reported net income or the change in net cash for the nine months ended July 31, 2012.

Update to Significant Accounting Policies. During the second fiscal quarter of 2013 typical standard warranty arrangements within our electronic measurement business were extended from one year to three years from the date of delivery. Prior to the change in standard warranty terms, we sold extended warranties of more than one year and less than three years which were deferred. Those existing warranties greater than one year and less than three years and previously classified as extended warranties will be amortized over the original period of the warranty. We will continue to sell extended warranties for terms beyond three years within the electronic measurement business. The impact will not be material to the segment or consolidated revenue of Agilent and the anticipated increase to the warranty accrual as a result of the new arrangements will not be material to the condensed consolidated balance sheet of Agilent. No changes were made to the standard and extended warranty terms within our other businesses. There have been no other material changes to our significant accounting policies, as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended October 31, 2012.

In the first quarter of 2013, we adopted the updated authoritative guidance that increases the prominence of items reported in other comprehensive income. For additional details related to the updated authoritative guidance, see Note 2, "New Accounting Pronouncements".

Fair Value of Financial Instruments. The carrying values of certain of our financial instruments including cash and cash equivalents, accounts receivable, accounts payable, accrued compensation and other accrued liabilities approximate fair value because of their short maturities. The fair value of long-term equity investments is determined using quoted market prices for those securities when available which are Level 1 inputs under the accounting guidance fair value hierarchy. For those long-term equity investments accounted for under the cost method, their carrying value approximates their estimated fair value. The fair value of our long-term debt, calculated from quoted prices which are primarily Level 1 inputs under the accounting guidance fair value hierarchy, exceeds their carrying value by approximately $96 million as of July 31, 2013. The fair value of foreign currency contracts used for hedging purposes is estimated internally by using inputs tied to active markets which are primarily level 2 inputs. These inputs, for example, interest rate yield curves, foreign exchange rates, and forward and spot prices for currencies are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. See also Note 8, "Fair Value Measurements" for additional information on the fair value of financial instruments.

Goodwill and Purchased Intangible Assets. In September 2011, the Financial Accounting Standards Board ("FASB") approved changes to the goodwill impairment guidance which are intended to reduce the cost and complexity of the annual impairment test. The changes provide entities an option to perform a qualitative assessment to determine whether further impairment testing is necessary. The revised standard gives an entity the option to first assess qualitative factors to determine whether performing the two-step test is necessary. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not (i.e. greater than 50% chance) that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test will be required. Otherwise, no further testing will be required.

Table of Contents

The revised guidance includes examples of events and circumstances that might indicate that a reporting unit's fair value is less than its carrying amount. These include macro-economic conditions such as deterioration in the entity's operating environment or industry or market considerations; entity-specific events such as increasing costs, declining financial performance, or loss of key personnel; or other events such as an expectation that a reporting unit will be sold or a sustained decrease in the stock price on either an absolute basis or relative to peers.

If it is determined, as a result of the qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the provisions of authoritative guidance require that we perform a two-step impairment test on goodwill. In the first step, we compare the fair value of each reporting unit to its carrying value. The second step (if necessary) measures the amount of impairment by applying fair-value-based tests to the individual assets and liabilities within each reporting unit. As defined in the authoritative guidance, a reporting unit is an operating segment, or one level below an operating segment. We aggregate components of an operating segment that have similar economic characteristics into our reporting units. During the third quarter of fiscal year 2012, we formed a fourth segment, diagnostics and genomics, from a portion of our life sciences segment. As a result, Agilent now has four segments, life sciences, chemical analysis, diagnostics and genomics and electronic measurement, which are the same as our reporting units. In fiscal year 2012, we assessed goodwill impairment for our reporting units; life sciences, chemical analysis, diagnostics and genomics, and electronic measurement. Based on the results of our qualitative test for goodwill impairment by reporting unit, as of September 30, 2012, we believe that it is more-likely-than-not that the fair value of each of our reporting units, life sciences, chemical analysis, diagnostics and genomics and electronic measurement is greater than their respective carrying values. There was no impairment of goodwill during the three and nine months ended July 31, 2013 and 2012.

Purchased intangible assets consist primarily of acquired developed technologies, proprietary know-how, trademarks, and customer relationships and are amortized using the best estimate of the asset's useful life that reflect the pattern in which the economic benefits are consumed or used up or a straight-line method ranging from 6 months to 15 years. In-process research and development ("IPR&D") is initially capitalized at fair value as an intangible asset with an indefinite life and assessed for impairment thereafter. When the IPR&D project is complete, it is reclassified as an amortizable purchased intangible asset and is amortized over its estimated useful life. If an IPR&D project is abandoned, Agilent will record a charge for the value of the related intangible asset to Agilent's consolidated statement of operations in the period it is abandoned.

In July 2012, the FASB simplified the guidance for testing for impairment of indefinite-lived intangible assets other than goodwill. The changes are intended to reduce compliance costs. Agilent's indefinite-lived intangible assets are IPR&D intangible assets. The revised guidance allows a qualitative approach for testing indefinite-lived intangible assets for impairment, similar to the issued impairment testing guidance for goodwill and allows the option to first assess qualitative factors (events and circumstances) that could have affected the significant inputs used in determining the fair value of the indefinite-lived intangible asset to determine whether it is more-likely-than-not (i.e. greater than 50% chance) that the indefinite-lived intangible asset is impaired. An organization may choose to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to calculating its fair value. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted. Agilent adopted this guidance for the year ended October 31, 2012. We recorded an impairment of zero and $1 million for the three and nine months ended July 31, 2013, respectively, due to the cancellation of an IPR&D project within our electronic measurement business. There was no impairment related to an IPR&D project during the three and nine months ended July 31, 2012.

2. NEW ACCOUNTING PRONOUNCEMENTS

In June 2011, the FASB issued guidance related to the presentation of comprehensive income. The guidance aims to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. The guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. In the first quarter of 2013, we adopted the updated authoritative guidance that increases the prominence of items reported in other comprehensive income. The updated authoritative guidance eliminates the option to present components of other comprehensive income as part of the statement of changes in equity and requires that changes in other comprehensive income be presented either as a single continuous statement of comprehensive income or in two but consecutive statements. The adoption of the updated authoritative guidance did impact the presentation of comprehensive income, as we have elected to present two separate but consecutive statements, but did not have an impact on our financial position or results of operations.

In December 2011, the FASB issued guidance related to the enhanced disclosures that will enable the users of financial statements to evaluate the effect or potential effect of netting arrangements of an entity's financial position. The amendments require improved information about financial instruments and derivative instruments that are either offset or subject to enforceable master netting arrangements or similar agreement. The guidance is effective for annual reporting periods beginning on or after

Table of Contents

January 1, 2013, and interim periods within those annual periods. We do not expect a material impact to our consolidated financial statements due to the adoption of this guidance.

In February 2013, the FASB issued the guidance for reporting of amounts reclassified out of accumulated other comprehensive income. The revised guidance requires reporting the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required to be reclassified in its entirety to net income. For other amounts that are not required to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures that provide additional detail about these amounts. The amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. The guidance is effective prospectively for annual reporting periods beginning after December 15, 2012 and interim periods within those years. Early adoption is permitted. We do not expect a material impact to our consolidated financial statements due to the adoption of this guidance.

In March 2013, the FASB issued an amendment to the accounting guidance on foreign currency matters in order to clarify the guidance for the release of cumulative translation adjustment. When a parent ceases to have a controlling interest in a subsidiary or group of assets within a foreign entity, the cumulative translation adjustment should be released into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. The guidance is effective for interim and annual periods beginning after December 15, 2013. We have no plans to deconsolidate a subsidiary or derecognize a group of assets in the near future and we do not expect a material impact to our consolidated financial statements due to the adoption of this guidance.

In July 2013, the FASB issued an amendment to the accounting guidance related to the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss or a tax credit carryforward exists. The guidance requires an unrecognized tax benefit to be presented as a decrease in a deferred tax asset where a net operating loss, a similar tax loss, or a tax credit carryforward exists and certain criteria are met. This guidance is effective prospectively for annual and interim reporting periods beginning after December 15, 2013 and is consistent with our current practice.

Other amendments to GAAP in the U.S. that have been issued by the FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on our consolidated financial statements upon adoption.

3. SHARE-BASED COMPENSATION

Agilent accounts for share-based awards in accordance with the provisions of the authoritative accounting guidance which requires the measurement and recognition of compensation expense for all share-based payment awards made to our employees and directors including employee stock option awards, restricted stock units, employee stock purchases made under our employee stock purchase plan ("ESPP") and performance share awards granted to selected members of our senior management under the long-term performance plan ("LTPP") based on estimated fair values.

The impact on our results for share-based compensation was as follows:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2013	2012	2013	2012
	(in millions)			
Cost of products and services	$4	$2	$15	$12

Research and development	3	2	10	8
Selling, general and administrative	11	11	43	40
Total share-based compensation expense	$18	$15	$68	$60

At July 31, 2013 there was no share-based compensation capitalized within inventory. For the three and nine months ended July 31, 2013, the windfall tax benefit realized from exercised stock options and similar awards was zero and $2 million, respectively. For the three and nine months ended July 31, 2012, the windfall tax benefits from exercised stock options and similar awards was zero.

Table of Contents

The following assumptions were used to estimate the fair value of the options and LTPP grants.

	Three Months Ended July 31, 2013	Three Months Ended July 31, 2012	Nine Months Ended July 31, 2013	Nine Months Ended July 31, 2012
Stock Option Plans:				
Weighted average risk-free interest rate	—	—	0.9 %	0.9 %
Dividend yield	—	—	1 %	—
Weighted average volatility	—	—	39 %	38 %
Expected life	—	—	5.8yrs	5.8yrs
LTPP:				
Volatility of Agilent shares	37 %	41 %	37 %	41 %
Volatility of selected peer-company shares	6%-64%	17%-75%	6%-64%	17%-75%
Price-wise correlation with selected peers	49 %	62 %	49 %	62 %

The fair value of share-based awards for employee stock option awards was estimated using the Black-Scholes option pricing model. Shares granted under the LTPP were valued using a Monte Carlo simulation model. Both the Black-Scholes and Monte Carlo simulation fair value models require the use of highly subjective and complex assumptions, including the option's expected life and the price volatility of the underlying stock. The estimated fair value of restricted stock unit awards is determined based on the market price of Agilent's common stock on the date of grant adjusted for expected dividend yield. On January 17, 2012, the company's Board of Directors approved the initiation of quarterly cash dividends to the company's shareholders. The fair value of all the awards granted prior to the declaration of quarterly cash dividend was measured based on an expected dividend yield of 0%. The ESPP allows eligible employees to purchase shares of our common stock at 85 percent of the purchase price and uses the purchase date to establish the fair market value.

We use historical volatility to estimate the expected stock price volatility assumption for employee stock option awards. In reaching the conclusion, we have considered many factors including the extent to which our options are currently traded and our ability to find traded options in the current market with similar terms and prices to the options we are valuing. In estimating the expected life of our options granted we considered the historical option exercise behavior of our executives, which we believe is representative of future behavior.

4. INCOME TAXES

Income tax expense was $44 million and $92 million for the three and nine months ended July 31, 2013, respectively, compared to an income tax benefit of $5 million and an income tax expense of $59 million for the same periods last year.

The increase in income tax expense for the three months ended July 31, 2013 relates primarily to the impact of discrete items. The income tax provision for the three months ended July 31, 2013 included a net $18 million discrete tax expense compared to a net $27 million discrete tax benefit for the same period last year. The net discrete tax expense for the three months ended July 31, 2013 was primarily driven by a $7 million decrease in deferred tax assets due to a reduction in the statutory tax rate in the U.K. and a $7 million additional tax expense due to return to provision adjustments associated with the filing of the 2012 tax returns in various jurisdictions. The net discrete tax benefit for the three months ended July 31, 2012 primarily related to favorable tax settlements and lapses in statute of limitations in foreign jurisdictions.

The increase in income tax expense for the nine months ended July 31, 2013 relates primarily to the impact of discrete items. The income tax provision for the nine months ended July 31, 2013 included a net $22 million discrete tax expense compared to a net $13 million discrete tax benefit for the same period last year. The net discrete tax expense for the nine months ended July 31, 2013 was primarily driven by the above mentioned $18 million discrete charges recognized in the third quarter of 2013 and a $12 million out of period adjustment to tax expense, recognized in the second quarter of 2013, associated with the write off of deferred tax assets related to foreign tax credits incorrectly claimed in prior years; partially offset by a $7 million discrete tax benefit, recognized in the first quarter of 2013, due to research and development tax credits relating to the company's prior fiscal year. The net discrete tax benefit for the nine months ended July 31, 2012 primarily related to favorable tax settlements and lapses in statute of limitations in foreign jurisdictions.

In the U.S., tax years remain open back to the year 2006 for federal income tax purposes and the year 2000 for significant states. Agilent's U.S. federal income tax returns for 2006 through 2007 are currently under audit by the IRS. During the three months ended July 31, 2012, the company received a Revenue Agents Report (“RAR”) for these years and filed a protest to dispute certain adjustments, the most significant of which pertains to the amount of a gain from the disposition of a business that was

Table of Contents

allocated to the U.S. for income tax purposes. There can be no assurance that the outcome of this dispute will not have a material effect on our operating results or financial condition. In other major jurisdictions where the company conducts business, the tax years generally remain open back to the year 2003. With these jurisdictions and the U.S., it is reasonably possible that there could be significant changes to our unrecognized tax benefits in the next twelve months due to either the expiration of a statute of limitation or a tax audit settlement. Given the number of years and numerous matters that remain subject to examination in various tax jurisdictions, management is unable to estimate the range of possible changes to the balance of our unrecognized tax benefits.

5. NET INCOME PER SHARE

The following is a reconciliation of the numerator and denominator of the basic and diluted net income per share computations for the periods presented below: