

Keysight Technologies

# Annual Report 2014



Unlocking Measurement Insights



# KEYSIGHT TECHNOLOGIES 2014 ANNUAL REPORT

**ANNUAL REPORT TO STOCKHOLDERS**  
ANNUAL REPORT CONSOLIDATED FINANCIAL STATEMENTS

## To Our Stockholders,

It has been 18 months since Agilent announced it would spin-off its electronic measurement business into a new company. The intention of the spin-off was to create two great companies with increased strategic and management focus, each well-positioned for growth in their respective markets.

On November 1, 2014, Keysight Technologies became an independent company and closed the books on a successful year. It was quite a year. As you read on, you will gain some insight into how we launched a \$2.9 billion start-up.

### Launching Keysight

On January 7, 2014, although still a business within Agilent, we attached a tangible identity to our new electronic measurement company by announcing its name as Keysight Technologies. Our name conveys the ability to see what others cannot. It means we have the critical insight to understand and unlock the answers to a rapidly and ever-changing technology landscape. Our initial tagline of “unlocking measurement insights for 75 years” acknowledges our roots in the original Hewlett-Packard Company from which our company was born.

The Keysight name is meant to represent the value that we bring to our customers. With our industry-leading measurement insights, engineers accelerate their understanding of new technology and their successes—whether it is being first to market, increasing differentiation, ramping production, or achieving lower cost of test. We exist to unlock key insights for our customers, and as a result, we create value for our stockholders.

As you can imagine, it takes work and focus to launch a new company while continuing to meet our commitments to customers and stockholders. We created a global team to separate our business and to bring our customers smoothly along this journey. We partnered with our customer base of more than 10,000 to transition their business from Agilent to Keysight without impacting order rates, shipments or satisfaction.

On November 1, we became an independent company, and the separation went exceptionally well. Two days later, on Monday, November 3, a small group of employees representing all those who did such an outstanding job of launching our company joined me on the podium of the New York Stock Exchange. Together, we rang the opening bell as Keysight Technologies stock began to trade on the NYSE under the ticker symbol “KEYS.” It was a proud moment for all 9,500 of us.

### 2014 Results and Operations

Even while separating from Agilent, our key focus was on running the day-to-day operations of our global business. Here’s a recap of 2014:

For the full year, as Agilent’s Electronic Measurement Group, Keysight generated revenues of \$2.93 billion, growing 2 percent on both an absolute and core basis, with an operating margin of 19.1 percent. With only modest topline growth in FY14, Keysight generated \$559 million in total operating profit, while investing 12.2 percent of revenue in research and development.

For the year, our Aerospace Defense business was down 4 percent, marked by a distinct contrast between the halves, and largely driven by the U.S. market. In the first half, Aerospace Defense was down 18 percent as it took time for the U.S. budget approvals to work their way through the government and prime contractors, and for spending to ramp. As we expected, the second half of the year improved and our Aerospace Defense revenues grew 11 percent year-over-year as a more typical seasonal demand returned.

Communications revenues grew 3 percent year-over-year with wireless manufacturing growth driven by strength in base station and component test. Industrial, Computers, and Semiconductor revenues grew 4 percent year-over-year with growth trends balanced across these end markets.

Turning to our products, in FY14, we reached several milestones for our key product categories. As an example of our ability to drive growth when we focus our efforts over time, we achieved record revenue for our oscilloscope product line. Our success in oscilloscopes is a result of a multi-year effort to invest in, and grow that business. And while we have been technology leaders in hardware for 75 years, in 2014, our annual software sales surpassed \$300 million.

2014 was a great year for Keysight. And we are just getting started. As an independent public company, we are focused—from our front-line employees to our executive team—on creating long-term value for our stockholders.

## **Strategy**

We enable our customers to bring leading electronic products to market faster and at a lower cost. Our key differentiation is that we provide value to our customers across their entire electronic product development cycle—from design simulation, to prototype test, to volume manufacturing. We deliver this value with leading technology and world-class support.

Our strategic imperative is to grow the business in order to create long-term shareholder value. We will do this by leveraging the strength of our business model, which delivers solid profitability and generates sustainable cash flows throughout the cycle, and by focusing on higher growth market opportunities, including wireless communications, modular solutions, and software. In all these areas, the ongoing evolution of technology creates demand for new measurement contributions and insights from Keysight.

I firmly believe that our focus to maintain strong profitability while increasing our growth rate, and our innate drive to innovate, will deliver long-term value for both our stockholders and customers.

## **Thank You**

At this point in our journey, I extend my heartfelt thanks to many key people:

- To you, our stockholders for your trust, and funding our commitment to create value.
- To our customers in more than 100 countries. Every day they challenge us to be better, and to help them bring electronic products to market faster and at a lower cost.
- To our Keysight employees for delivering excellent results while launching a new company. I am grateful for the many long hours our employees worked, as well as for their families and the sacrifices they made in support of launching Keysight.

While we deeply thank our past partners from Hewlett Packard and Agilent for bringing us to this pivotal time, we know that our success is not about the past 75 years, but about our future.

“This is our time” has been our rallying cry inside Keysight since announcing the decision to launch our company. This is our time to innovate and grow in electronic measurement, and this is our time to create value for you.



Ron Nersesian  
President and Chief Executive Officer

February 6, 2015

## Keysight at a Glance

Keysight is the world's premier electronic measurement company providing electronic measurement solutions to communications and electronics industries. We provide electronic measurement instruments and systems and related software, software design tools, and related services that are used in the design, development, manufacture, installation, deployment and operation of electronics equipment. Related services include start-up assistance, instrument productivity and application services and instrument calibration and repair. We also offer customization, consulting and optimization services throughout the customer's product lifecycle.

On September 19, 2013, Agilent Technologies, Inc. ("Agilent") announced plans to separate into two publicly-traded companies, one comprised of the life sciences, diagnostics and chemical analysis businesses that retained the Agilent name and the other comprised of the electronic measurement business ("Keysight"). The separation was completed on November 1, 2014 through a pro rata distribution of Keysight shares to Agilent shareholders that is intended to be tax-free for U.S. federal income tax purposes.

In fiscal 2014, in conjunction with the planned separation, we reorganized our business into two operating segments, the measurement solutions segment and customer support and services segment. The measurement solutions segment consists of businesses that sell hardware and software products including radio frequency, microwave, digital and other test technology solutions. The customer support and services segment consists of businesses that provide repair and calibration services for our customers' installed base of instruments and facilitates the resale of refurbished used equipment.

We have a comprehensive sales strategy that uses our direct sales force, distributors, resellers and manufacturer's representatives. The strategy varies based on the size of customer, the complexity of products and geographical coverage. Of our total net revenue of \$2.9 billion for the fiscal year ended October 31, 2014, we generated 36 percent in the United States and 64 percent outside the United States.

As of October 31, 2014, we employed approximately 9,600 people worldwide. We generated \$2.9 billion of net revenue in fiscal year 2014, \$2.9 billion in fiscal year 2013 and \$3.3 billion in fiscal year 2012.

Our primary research and development and manufacturing sites are in California and Colorado in the United States and outside the United States in China, Germany, India, Japan, Malaysia, Singapore and Spain.

| Operating Segments    | 2014 Net Revenue | Description  |
|-----------------------|------------------|--|
| Measurement Solutions | \$2.5 billion    | <p><b>Summary:</b> Our measurement solutions business provides electronic measurement instruments and systems with related software and software design tools that are used in the design, development, manufacture, installation, deployment and operation of electronics equipment. We provide startup assistance, consulting, optimization and application support throughout the customer's product lifecycle. We employed approximately 8,500 people as of October 31, 2014 in our measurement solutions business.</p> <p><b>Markets:</b> The market for our measurement solutions segment include communications test market; aerospace and defense test market; and industrial, computer and semiconductor test market.</p> |

*Communications Test Market:* this market includes, network equipment manufacturers (“NEM”), wireless device manufacturers, and communication service providers (which include component manufacturers within the supply chain for these customers). NEMs require test and measurement instruments, systems and solutions for the development, production and installation of their network technology. Wireless device manufacturers require test and measurement products for the design, development, manufacture and repair of mobile devices. Communications service providers require a wide range of sophisticated test instruments and systems to ensure conformance to communication standards and network requirement and evaluate network performance. The component manufacturers require test and measurement products to verify that the performance of their components and modules meet the specifications of their NEM and device customers.

*Aerospace and Defense Test Market:* this market includes commercial and government customers and their contract suppliers. The modernization of satellite, radar and surveillance systems worldwide are drivers of test demand within the aerospace and defense market. Customers in this market use our electronic measurement instruments to develop and manufacture a wide variety of electronic components and systems used in aerospace and defense industry including commercial and military aircraft, space, satellite, radar, intelligence and surveillance.

*Industrial, Computer and Semiconductor Test Market:* this market includes customers in the design, development and manufacturing of a wide range of products, such as computers, computer peripherals, electronic components, consumer electronics, enterprise servers, storage networks and automotive electronics. These customers use test solutions in developing and manufacturing a wide variety of electronic components and systems, including testing the electrical parameters of digital, radio frequency, and microwave frequency components and assemblies; testing multiple parameters of the printed circuit boards used in almost every electronic device; testing of the final product; and testing of systems containing multiples electronic instruments. For semiconductor and board test applications, customers use our solutions in the design, development, manufacture, installation, deployment, and operation of semiconductor and printed circuit assemblies.

**Product Areas:** We divide our measurement solutions products into radio frequency and microwave instruments, digital instruments and various other general purpose test instruments and targeted test solutions. We offer these products and related software in a variety of form factors, including bench top, modular and handheld, depending on the specific requirements of the customer application.

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Customer Support and Services      **\$400 million**

**Summary:** The customer support and services business provides accredited repair and calibration services for our installed base instrument customers and facilitates the resale of used equipment. Our customer support and services business enables our customers to maximize the value from their electronic measurement equipment through system uptime support, customer site resident professionals, on-site calibrations and localized service centers. Providing these services assures a high level of instrument performance and availability while minimizing the cost of ownership and equipment downtime. We employed approximately 1,100 people as of October 31, 2014 in our customer support and services business.

**Markets:** Our customer support and services business broadly addresses the same markets as the measurement solutions business, which includes the communications, aerospace and defense and industrial, computer and semiconductor test markets.

**Product Areas:** Our customer support and services business provides accredited repair and calibration services for our electronic measurement instruments. We also manage instrument trade-in programs and refurbish and sell used instruments.

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## **Senior Executives**

Ronald S. Nersesian\*  
President and  
Chief Executive Officer

Jay Alexander\*  
Senior Vice President and  
Chief Technology Officer

Neil Dougherty\*  
Senior Vice President and  
Chief Financial Officer

Ingrid Estrada\*  
Senior Vice President,  
Human Resources

Michael Gasparian\*  
Senior Vice President,  
Customer Support and Services &  
Worldwide Marketing

Soon Chai Gooi\*  
Senior Vice President,  
Order Fulfillment &  
Infrastructure

Hamish Gray  
Senior Vice President,  
Corporate Services and  
Chief of Staff

Guy Séné\*  
Senior Vice President,  
Measurement Solutions and  
Worldwide Sales

John Skinner\*  
Vice President,  
Corporate Controller and  
Principal Accounting Officer

Stephen D. Williams\*  
Senior Vice President, General  
Counsel and Secretary

## **Directors**

Paul N. Clark,  
Non-executive Chairman,  
Keysight Technologies, Inc.  
Operating Partner of Genstar  
Capital, LLC

Ronald S. Nersesian,  
Chief Executive Officer,  
Keysight Technologies, Inc.

James G. Cullen, Non-executive  
Chairman, Agilent  
Technologies, Inc.  
Former President and Chief  
Operating Officer, Bell Atlantic

Charles J. Dockendorff,  
Executive Vice President and  
Chief Financial Officer,  
Covidien, PLC

Jean M. Halloran, Former  
Senior Vice President, Agilent  
Technologies, Inc.

Richard Hamada, Chief  
Executive Officer, Avnet, Inc.

## **Board Committee**

Audit and Finance Committee  
Charles J. Dockendorff,  
Chairperson  
Paul N. Clark

Compensation Committee  
James G. Cullen,  
Chairperson  
Richard Hamada

Nominating/Corporate Governance  
Committee  
Paul N. Clark  
Chairperson  
James G. Cullen  
Charles J. Dockendorff  
Richard Hamada

Executive Committee  
Paul N. Clark,  
Chairperson  
Ronald S. Nersesian

*\*These individuals are executive officers of Keysight under Section 16 of the Securities Act of 1934*



Keysight's annual meeting of stockholders will take place on Thursday, March 19, 2015 at 8:00 a.m. at Keysight's headquarters located at 1400 Fountaingrove Parkway, Santa Rosa, California 95403.

### **Investor Information**

Please see the full and audited financial statements and footnotes contained in this booklet. To receive paper copies of the annual report, proxy statement, Form 10-K, earnings announcements and other financial information, you should call (707) 577-6915. In addition, you can access this financial information at Keysight's Investor Relations Website. The address is <http://www/investor.keysight.com>. This information is also available by writing to the address provided under the Investor Contact heading below.

### **Corporate Governance, Business Conduct and Ethics**

Keysight's Corporate Governance Standards, the charter of our Audit and Finance Committee, our Compensation Committee, our Executive Committee and our Nominating/Corporate Governance Committee, as well as our Standard of Business Conduct (including code of ethics provisions that apply to our principal executive officer, principal financial officer, principal accounting officer and senior financial officers) are available on our website at [www.investor.keysight.com](http://www.investor.keysight.com) under "Corporate Governance." These items are also available in print to any stockholder by calling (707) 577-6915. This information is also available by writing to the company at the address provided below.

### **Keysight Headquarters**

Keysight Technologies, Inc.  
1400 Fountaingrove Parkway  
Santa Rosa, CA 95403  
Phone: (800) 829-4444

### **Transfer Agent and Registrar**

Please contact our transfer agent, at the phone number or address listed below, with any questions about stock certificates, transfer of ownership or other matters pertaining to your stock account.

#### **Written Request:**

Computershare  
P.O. Box 30170  
College Station, TX 77842-3170

#### **Overnight Delivery:**

Computershare  
211 Quality Circle, Suite 210  
College Station, TX 77845

#### **Telephone Inquiries:**

Within the U.S., Canada, or Puerto Rico: (877) 373-6374  
Non-U.S.: (781) 575-2879

**Investor Center Website:** [www-us.computershare.com/investor/contact](http://www-us.computershare.com/investor/contact)

**Email for Computershare:** [web.queries@computershare.com](mailto:web.queries@computershare.com)

## **Investor Contact**

Keysight Technologies, Inc.  
Investor Relations Department  
1400 Fountaingrove Parkway  
Santa Rosa, CA 95403  
Email: investor.relations@keysight.com  
Phone: (707) 577-6915

## **Additional Information**

This annual report, including the letter titled “To Our Stockholders,” contains forward-looking statements including, without limitation, statements regarding trends, seasonality, cyclicity and growth in, and drivers of the markets we sell into, our strategic direction, our future effective tax rate and tax valuation allowance, earnings from our foreign subsidiaries, remediation activities, new product and service introductions, the ability of our products to meet market needs, changes to our manufacturing processes, the use of contract manufacturers, the impact of local government regulations on our ability to pay vendors or conduct operations, our liquidity position, our ability to generate cash from operations, growth in our businesses, our investments, the potential impact of adopting new accounting pronouncements, our financial results, our purchase commitments, our contributions to our pension plans, the selection of discount rates and recognition of any gains or losses for our benefit plans, our cost-control activities, savings and headcount reduction recognized from our restructuring programs and other cost saving initiatives, uncertainties relating to regulatory approvals, the integration of our acquisitions and other transactions, the separation from Agilent, our transition to lower-cost regions, and the existence of economic instability, that involve risks and uncertainties. Our actual results could differ materially from the results contemplated by these forward-looking statements due to various factors, including those detailed in Keysight’s filings with the Securities and Exchange Commission, including our Annual Report on Form 10-K for the year ended October 31, 2014.

The materials contained in this annual report are as of December 22, 2014, unless otherwise noted. The content of this annual report contains time-sensitive information that is accurate only as of this date. If any portion of this annual report is redistributed at a later date, Keysight will not be reviewing or updating the material in this report. The information on page 6 regarding our senior executives and directors is current as of February 6, 2015.

This annual report contains Keysight’s 2014 audited financial statements and notes thereto in the following section of this booklet with the tab “Annual Report Financials.” Within the Annual Report Financials, please refer to “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Risks, Uncertainties and Other Factors That May Affect Future Results” for more complete information on each of our businesses and Keysight as a whole.



# KEYSIGHT TECHNOLOGIES 2014 ANNUAL REPORT

ANNUAL REPORT TO STOCKHOLDERS  
ANNUAL REPORT CONSOLIDATED FINANCIAL STATEMENTS

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**SELECTED FINANCIAL DATA**  
(unaudited)

|   | Years Ended October 31,              |          |          |          |          |
|---|--------------------------------------|----------|----------|----------|----------|
|   | 2014                                 | 2013     | 2012     | 2011     | 2010     |
|   | (in millions, except per share data) |          |          |          |          |
| <b>Combined and Consolidated Statement of Operations</b>  |                                      |          |          |          |          |
| <b>Data:</b>  |                                      |          |          |          |          |
| Net revenue . . . . .                                     | \$ 2,933                             | \$ 2,888 | \$ 3,315 | \$ 3,316 | \$ 2,706 |
| Income before taxes . . . . .                             | \$ 475                               | \$ 501   | \$ 746   | \$ 749   | \$ 360   |
| Net income . . . . .                                      | \$ 392                               | \$ 457   | \$ 841   | \$ 787   | \$ 355   |
| Basic and diluted net income per share(a) . . . . .       | \$ 2.35                              | \$ 2.74  | \$ 5.04  | \$ 4.71  | \$ 2.13  |
| Basic and diluted average shares outstanding(a) . . . . . | 167                                  | 167      | 167      | 167      | 167      |

|  | October 31,   |          |          |          |          |
|--|---------------|----------|----------|----------|----------|
|  | 2014          | 2013     | 2012     | 2011     | 2010     |
|  | (in millions) |          |          |          |          |
| <b>Combined and Consolidated Balance Sheet Data:</b>     |               |          |          |          |          |
| Cash and cash equivalents and short-term investments . . | \$ 810        | \$ —     | \$ —     | \$ —     | \$ —     |
| Working capital . . . . .                                | \$ 1,081      | \$ 412   | \$ 398   | \$ 272   | \$ 199   |
| Total assets . . . . .                                   | \$ 3,050      | \$ 2,028 | \$ 2,133 | \$ 1,908 | \$ 1,766 |
| Long-term debt . . . . .                                 | \$ 1,099      | \$ —     | \$ —     | \$ —     | \$ —     |
| Stockholders'/Invested equity . . . . .                  | \$ 769        | \$ 1,245 | \$ 1,305 | \$ 996   | \$ 817   |

(a) On November 1, 2014, Agilent Technologies, Inc. distributed 167 million shares of Keysight common stock to existing holders of Agilent common stock. Basic and diluted net income per share for all periods through October 31, 2014 is calculated using the shares distributed on November 1, 2014. Refer to Note 6 of the combined and consolidated financial statements for information regarding earnings per common share.

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

You should read the following discussion in conjunction with the combined and consolidated financial statements and notes thereto included elsewhere in this Annual Report on Form 10-K. This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements. The forward-looking statements contained herein include, without limitation, statements regarding trends, seasonality, cyclicalities and growth in, and drivers of, the markets we sell into, our strategic direction, our future effective tax rate and tax valuation allowance, earnings from our foreign subsidiaries, remediation activities, new product and service introductions, the ability of our products to meet market needs, changes to our manufacturing processes, the use of contract manufacturers, the impact of local government regulations on our ability to pay vendors or conduct operations, our liquidity position, our ability to generate cash from operations, growth in our businesses, our investments, the potential impact of adopting new accounting pronouncements, our financial results, our purchase commitments, our contributions to our pension plans, the selection of discount rates and recognition of any gains or losses for our benefit plans, our cost-control activities, savings and headcount reduction recognized from our restructuring programs and other cost saving initiatives, and other regulatory approvals, the integration of our acquisitions and other transactions, our transition to lower-cost regions, and the existence of economic instability, that involve risks and uncertainties. Our actual results could differ materially from the results contemplated by these forward-looking statements due to various factors, including those discussed in Item 1A and elsewhere in this Form 10-K.

### **Basis of Presentation and Separation from Agilent**

On November 1, 2014, Keysight Technologies, Inc. ("we," "our," "Keysight" or "the company") became an independent publicly-traded company through the distribution by Agilent Technologies, Inc. ("Agilent") of 100 percent of the outstanding common stock of Keysight to Agilent's shareholders (the "Separation"). Each Agilent shareholder of record as of the close of business on October 22, 2014, received one share of Keysight common stock for every two shares of Agilent common stock held on the record date. Keysight was incorporated in Delaware on December 6, 2013 and is comprised of Agilent's former electronic measurement business. Keysight's Registration Statement on Form 10 was declared effective by the U.S. Securities and Exchange Commission on October 6, 2014. Keysight's common stock began trading "regular-way" under the ticker symbol "KEYS" on the New York Stock Exchange on November 3, 2014.

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.

Prior to the distribution, Agilent transferred substantially all of the assets and liabilities and operations of the electronic measurement business to Keysight in August 2014 ("the Capitalization"). Combined financial statements prior to the Capitalization were prepared on a stand-alone basis and were derived from Agilent's consolidated financial statements and accounting records. The combined financial statements included elsewhere in this Annual Report on Form 10-K reflect our financial position, results of operations, comprehensive income and cash flows as our business was operated as part of Agilent prior to the Capitalization. Following the Capitalization the consolidated financial statements include the accounts of the company and our wholly-owned subsidiaries. All periods have been accounted for in conformity with U.S. generally accepted accounting principles.

For periods prior to the Capitalization, the combined and consolidated financial statements included the allocation of certain assets and liabilities that were historically held at the Agilent level but which were specifically identified or allocated to us. Cash and cash equivalents held by Agilent were not allocated to us. Agilent's debt and related interest expense were not allocated to us since we are not the legal obligor of the debt and Agilent's borrowings were not directly attributable to us. In addition, prior to the

Capitalization, all intercompany transactions between us and Agilent were considered to be effectively settled at the time the transactions were recorded. All cash generated by our business was assumed to be remitted to the Agilent subsidiary located in the same legal entity or country. The total net effect of the settlement of these intercompany transactions prior to the Capitalization is reflected in the combined and consolidated statement of cash flows as a financing activity and in the combined and consolidated balance sheet as Agilent net investment.

On October 15, 2014, we issued \$500 million of 3.30 percent senior notes due in 2019 and \$600 million of 4.55 percent senior notes due in 2024. A portion of the proceeds from the offering was used to make a \$900 million cash distribution to Agilent in October 2014. We intend to use the remaining proceeds to fund working capital and other liquidity needs.

The combined and consolidated statement of operations includes our direct expenses for cost of products and services sold, research and development, sales and marketing, distribution, and administration as well as allocations of expenses arising from shared services and infrastructure provided by Agilent to us. These allocated expenses include costs of information technology, accounting and legal services, real estate and facilities, corporate advertising, insurance services, treasury and other corporate and infrastructure services. In addition, other costs allocated to us include restructuring costs, share-based compensation expense and retirement plan expenses related to Agilent's corporate and shared services employees. These expenses are allocated to us using estimates that we consider to be a reasonable reflection of the utilization of services provided to or benefits received by us. These costs have been allocated to us on the basis of direct usage when identifiable, with the remainder allocated on a pro-rata basis of revenue, square footage, headcount or other measures.

We expect Agilent to continue to provide some of these services related to these functions on a transitional basis for a fee, which will be partially offset by other income from Keysight services provided to Agilent. These services will be received or provided under a transition services agreement. We do not expect the net costs associated with the transition services agreement to be materially different than the historical costs that have been allocated to us related to these same services.

We also expect to incur other incremental costs as an independent, publicly traded company as compared to the costs historically allocated to us by Agilent. These incremental costs are estimated to be approximately \$20 million on an annual pre-tax basis. For the fiscal year 2014, we recognized \$78 million of non-recurring transaction and pre-separation costs. We expect to recognize additional non-recurring transaction and separation costs, which are currently estimated to range from \$25 million to \$30 million through fiscal 2016. These costs are expected to include, among other things, branding, legal, accounting and other advisory fees and other costs to separate and transition from Agilent.

## **Overview and Executive Summary**

We provide electronic measurement instruments and systems and related software, software design tools, and related services that are used in the design, development, manufacture, installation, deployment and operation of electronics equipment. Related services include start-up assistance, instrument productivity and application services and instrument calibration and repair. We also offer customization, consulting and optimization services throughout the customer's product lifecycle.

Historically, we conducted our business in one reportable operating segment for Agilent. In fiscal 2014, in conjunction with the planned separation, we implemented changes in our organizational structure which resulted in the formation of two reportable operating segments, measurement solutions and customer support and services. The measurement solutions segment is primarily the hardware and associated software businesses serving the electronic measurement market. The customer support and services segment provides repair and calibration of the hardware measurement solutions and the resale of used instrument equipment.

*Years ended October 31, 2014, 2013 and 2012*

Total orders in 2014 were \$2,963 million, an increase of 3 percent when compared to 2013. Orders increased in all market segments including aerospace and defense; industrial, computer, and semiconductor test; and communications test. Foreign currency movements had an unfavorable impact of 1 percentage point on the year-over-year comparison. Orders of \$2,866 million in 2013 declined 13 percent when compared to 2012 on declines in all market segments, including aerospace and defense; industrial, computer and semiconductor test; and communications test.

Net revenue of \$2,933 million in 2014 increased 2 percent when compared to 2013, with industrial, computer and semiconductor test contributing 2 percentage points of the increase, and communication test contributing 1 percentage point of the increase, partially offset by a decline in aerospace and defense revenue. Foreign currency movements had an unfavorable impact of 1 percentage point on the year over year comparison. Net revenue of \$2,888 million in 2013 declined 13 percent when compared to 2012, with lower communications test revenue contributing 8 percentage points of the decline, and lower industrial, computer and semiconductor test revenue further decreasing revenue by approximately 5 percentage points, while aerospace and defense was flat year over year.

Net income was \$392 million in 2014 compared to net income of \$457 million in 2013 and \$841 million in 2012. In 2014, 2013 and 2012, we generated operating cash flows of \$563 million, \$566 million and \$724 million, respectively.

Looking forward, while we believe the long-term growth rate of our markets is 3 to 4 percent, we expect lower fiscal 2015 market growth in the range of 2.5 to 3.5 percent. As an independent publicly-traded company, we are focused on growing in our markets while meeting our financial commitments. We intend to leverage our unique formula of hardware plus software plus people to create value for our customers and shareholders.

### **Critical Accounting Policies and Estimates**

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in our combined and 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. An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used or changes in the accounting estimate that are reasonably likely to occur could materially change the financial statements. 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, allocation methods and allocated expenses from Agilent, share-based compensation, retirement and post-retirement plan assumptions, valuation of goodwill and purchased intangible assets, restructuring and accounting for income taxes.

*Revenue recognition.* We enter into agreements to sell products (hardware and/or software), services, and other arrangements (multiple-element arrangements) that include combinations of products and services. Revenue from product sales, net of trade discounts and allowances, is recognized provided that persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable and collectability is reasonably assured. Delivery is considered to have occurred when title and risk of loss have transferred to the customer, for products, or when the service has been provided. Revenue is reduced for estimated product returns, 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 occurs when the installation is complete. Otherwise, neither the product nor the installation revenue is recognized until the installation is complete. Revenue from services is deferred and recognized over the contractual period or as services are rendered and accepted by the customer. We allocate revenue to each element in our multiple-element arrangements based upon their relative selling prices. We determine the selling price for each deliverable based on a selling price hierarchy. The selling price for a deliverable is based on our vendor specific objective evidence (“VSOE”) if available, third-party evidence (“TPE”) if VSOE is not available, or estimated selling price (“ESP”) if neither VSOE nor TPE is available. Revenue from the sale of software products that are not required to deliver the tangible product’s essential functionality are accounted for under software revenue recognition rules. Revenue allocated to each element is then recognized when the basic revenue recognition criteria for that element have been met. The amount of product revenue recognized is affected by our judgments as to whether an arrangement includes multiple elements.

We use VSOE of selling price in the selling price allocation in all instances where it exists. VSOE of selling price for products and services is determined when a substantial majority of the selling prices fall within a reasonable range when sold separately. TPE of selling price can be established by evaluating largely interchangeable competitor products or services in standalone sales to similarly situated customers. As our products contain a significant element of proprietary technology and the solution offered differs substantially from that of competitors, it is difficult to obtain the reliable standalone competitive pricing necessary to establish TPE. ESP represents the best estimate of the price at which we would transact a sale if the product or service were sold on a standalone basis. We determine ESP for a product or service by using historical selling prices which reflect multiple factors including, but not limited to customer type, geography, market conditions, competitive landscape, gross margin objectives and pricing practices. The determination of ESP is made through consultation with and approval by management. We may modify or develop new pricing practices and strategies in the future. As these pricing strategies evolve, changes may occur in ESP. The aforementioned factors may result in a different allocation of revenue to the deliverables in multiple-element arrangements, which may change the pattern and timing of revenue recognition for these elements but will not change the total revenue recognized for the arrangement.

*Inventory valuation.* We assess the valuation of our inventory on a periodic basis and make adjustments to the value for estimated excess and obsolete inventory based upon estimates about future demand and actual usage. Such estimates are difficult to make under most economic conditions. The excess balance determined by this analysis becomes the basis for our excess inventory charge. Our excess inventory review process includes analysis of 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 to customers, resulting in lower cost of sales and higher income from operations than expected in that period.

*Allocations.* Agilent allocated certain costs such as share-based compensation expense and retirement and post-retirement benefit plan expense relating to our employees and Agilent’s corporate and shared services employees. These expenses were subject to certain underlying assumptions mentioned below.

*Share-based compensation.* Prior to the Separation, Keysight employees participated in Agilent’s stock program. Share-based compensation expense has been allocated to us based on Keysight employees participating in Agilent’s stock plan and our share of Agilent’s corporate and shared services employee costs based on our share of revenue. Agilent accounts for share-based awards in accordance with the authoritative guidance where share-based compensation expense is primarily based on estimated grant date fair value and is recognized on a straight-line basis. 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 Long-Term Performance (“LTP”) Program were valued using the Monte Carlo simulation model. 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. The Employee Stock Purchase Plan ("ESPP") allows eligible employees to purchase shares of Agilent's common stock at 85 percent of the purchase price and uses the purchase date to establish the fair market value. Both the Black-Scholes and Monte Carlo simulation fair-value models require the use of highly subjective and complex assumptions used by Agilent, including the option's expected life and the price volatility of Agilent stock. The assumptions used in calculating the fair value of share-based awards represent Agilent's best estimates, but these estimates involve inherent uncertainties and the application of management judgment. Although we believe the assumptions and estimates made are reasonable and appropriate, changes in assumptions could materially impact our reported financial results.

*Retirement and post-retirement benefit plan assumptions.* Prior to the Capitalization, substantially all of our employees were covered under various defined benefit and/or defined contribution retirement plans sponsored by Agilent. We have accounted for our employee participation in Agilent's defined benefit retirement plans and the post-retirement health care plan as multiemployer plans. As a result, no asset or liability was recorded by us to recognize the funded status of such plans in our combined and consolidated balance sheet prior to the Capitalization. At the Capitalization, the assets and liabilities of these plans that were allocable to Keysight employees were transferred to Keysight plans; therefore, the plans are no longer considered multi-employer plans.

Our combined and consolidated statements of operations include expense that has been allocated to us based on Keysight employees participating in these plans and our share of Agilent's corporate and shared services employee costs. We consider the expense allocation methodology and results to be reasonable for all periods presented. At Capitalization, we established defined benefit retirement and post-retirement plans for our current and former employees. The defined benefit retirement and post-retirement obligations relating to those participants in these plans were transferred from Agilent's plans to our defined benefit plans. A proportionate share of the defined benefit plan assets was allocated from the Agilent pension trust in each applicable country to a newly established Keysight pension trust. Subject to local law, it is anticipated that the share of assets allocated to us will be in the same proportion as the projected benefit obligation of our participants to the total projected benefit obligation of Agilent.

Retirement and post-retirement benefit plan costs are a significant cost of doing business. They represent obligations that will ultimately be settled sometime in the future and therefore are subject to estimation. Pension accounting is intended to reflect the recognition of future benefit costs over the employees' average expected future service to Keysight based on the terms of the plans and investment and funding decisions. To estimate the impact of these future payments and our decisions concerning funding of these obligations, we are required to make assumptions using actuarial concepts within the framework of accounting principles generally accepted in the U.S. Two critical assumptions are the discount rate and the expected long-term return on plan assets. Other important assumptions include, expected future salary increases, expected future increases to benefit payments, expected retirement dates, employee turnover, retiree mortality rates, and investment portfolio composition. We evaluate these assumptions at least annually.

The discount rate is used to determine the present value of future benefit payments at the measurement date, which is October 31 for both U.S. and non-U.S. plans. For 2014, the U.S. discount rates were based on the results of matching expected plan benefit payments with cash flows from a hypothetically constructed bond portfolio. For 2014, the discount rate for non-U.S. plans was generally based on published rates for high-quality corporate bonds. If we changed our discount rate by 1 percent, the impact would be \$4 million on U.S. net periodic benefit cost and \$12 million on non-U.S. net periodic benefit cost. Lower discount rates increase the present value of the liability and subsequent year pension expense; higher discount rates decrease the present value of the liability and subsequent year pension expense.

The company uses alternate methods of amortization, as allowed by the authoritative guidance, that amortizes the actuarial gains and losses on a consistent basis for the years presented. For U.S. plans, gains and losses are amortized over the average future working lifetime. For most non-U.S. plans and U.S. post-retirement benefit plans, gains and losses are amortized using a separate layer for each year's gains and losses. The expected long-term return on plan assets is estimated using current and expected asset allocations as well as historical and expected returns. Plan assets are valued at fair value. If we changed our estimated return on assets by 1 percent, the impact would be \$7 million on U.S. net periodic benefit cost and \$13 million on non-U.S. net periodic benefit cost.

*Goodwill and other intangible assets.* We review goodwill for impairment annually during our fourth fiscal quarter and whenever events or changes in circumstances indicate the carrying value may not be recoverable. As defined in the authoritative guidance, a reporting unit is an operating segment, or one level below an operating segment. We aggregated components of an operating segment that have similar economic characteristics into our reporting units. At the time of an acquisition, we assign goodwill to the reporting unit that is expected to benefit from the synergies of the combination.

Companies have the option to perform a qualitative assessment to determine whether performing the two-step quantitative test is necessary. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not (i.e. > 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.

The guidance includes examples of events and circumstances that might indicate that a reporting unit's fair value is less than its carrying amount. These examples 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. The qualitative indicators replace those previously used to determine whether an interim goodwill impairment test is required. 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.

Historically we conducted our business in a single operating segment and reporting unit. In fiscal 2014, in conjunction with the planned separation, we implemented changes in our organizational structure which resulted in the formation of two reportable operating segments. In fiscal year 2014, we assessed goodwill impairment for our two reporting units which consisted of our two segments, Measurement Solutions and Customer Support and Services. We performed a quantitative test of goodwill impairment for both reporting units as of September 30, 2014. Based on the results of our testing, the fair value for both reporting units was significantly in excess of the carrying value. There was no impairment of goodwill during the years ended October 31, 2014, 2013 and 2012. Each quarter we review the events and circumstances to determine if goodwill impairment is indicated.

*Warranty.* Our standard warranty term for most of our products from the date of delivery is typically three years, which increased from one year in the second quarter of fiscal 2013. We accrue for standard warranty costs based on historical trends in warranty charges as a percentage of net product revenue. The accrual is reviewed regularly and periodically adjusted to reflect changes in warranty cost estimates. Estimated warranty charges are recorded within cost of products at the time related product revenue is recognized.

We also sell extended warranties that provide warranty coverage beyond the standard warranty term. Revenue associated with extended warranties is deferred and recognized over the extended coverage period.

*Restructuring.* The main component of our restructuring plan is related to workforce reductions. Workforce reduction charges are accrued when payment of benefits becomes probable and the amounts can be estimated. If the amounts and timing of cash flows from restructuring activities are significantly different from what we have estimated, the actual amount of restructuring and other related charges could be materially different, either higher or lower, than those we have recorded.

*Accounting for income taxes.* We must make certain estimates and judgments in determining income tax expense for financial statement purposes. These estimates and judgments occur in the calculation of tax credits, benefits and deductions, and in the calculation of certain tax assets and liabilities which arise from differences in the timing of recognition of revenue and expense for tax and financial statement purposes, as well as interest and penalties related to uncertain tax positions. Significant changes to these estimates may result in an increase or decrease to our tax provision in a subsequent period.

Significant management judgment is also required 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 net operating losses or foreign tax credit carryforwards will not be realized, a valuation allowance must be established for the amount of the deferred tax assets that cannot be realized. We consider all available positive and negative evidence on a jurisdiction-by-jurisdiction basis when assessing whether it is more likely than not that deferred tax assets are recoverable. We consider evidence such as our past operating results, the existence of losses in recent years and our forecast of future taxable income. In the fourth quarter of fiscal 2012 we released the valuation allowance for the majority of our U.S. deferred tax assets. At October 31, 2014, we continue to maintain a valuation allowance for certain U.S. state and foreign deferred tax assets. We intend to maintain a valuation allowance in these jurisdictions until sufficient positive evidence exists to support its reversal.

We have not provided for all U.S. federal income and foreign withholding taxes on the undistributed earnings of some of our foreign subsidiaries because we intend to reinvest such earnings permanently. Should we decide to remit this income to the U.S. in a future period, our provision for income taxes will increase materially in that period.

The calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax law and regulations in a multitude of jurisdictions. Although the guidance on the accounting for uncertainty in income taxes prescribes the use of a recognition and measurement model, the determination of whether an uncertain tax position has met those thresholds will continue to require significant judgment by management. In accordance with the guidance on the accounting for uncertainty in income taxes, for all U.S. and other tax jurisdictions, we recognize potential liabilities for anticipated tax audit issues based on our estimate of whether, and the extent to which, additional taxes and interest will be due. The ultimate resolution of tax uncertainties may differ from what is currently estimated, which could result in a material impact on income tax expense. If our estimate of income tax liabilities proves to be less than the ultimate assessment, a further charge to expense would be required. If events occur and the payment of these amounts ultimately proves to be unnecessary, the reversal of the liabilities would result in tax benefits being recognized in the period when we determine the liabilities are no longer necessary. We include interest and penalties related to unrecognized tax benefits within the provision for income taxes in the combined and consolidated statements of operations.

We have calculated our taxes on a separate return basis. However, the amounts recorded are not necessarily representative of the amounts that would have been reflected in the financial statements had we been an entity that operated independently of Agilent. It is possible that we will make different tax accounting elections and assertions, such as the amount of earnings that will be permanently reinvested outside the U.S. following our distribution from Agilent. Consequently, our future results after our separation from Agilent may be materially different from our historical results.

## Adoption of New Pronouncements

See Note 2, “New Accounting Pronouncements,” to the combined and consolidated financial statements for a description of new accounting pronouncements.

## Restructuring

In fiscal 2013, we recognized \$15 million of restructuring charges associated with the targeted headcount reduction of approximately 200 regular employees, representing approximately 2 percent of our global workforce. Through the end of fiscal 2014, approximately \$11 million was paid out under this program for the termination of 145 employees and \$3 million of accrual has been reversed related to 40 employees who have been redeployed within the company. As of October 31, 2014, we have a remaining accrual of \$1 million and have substantially completed this program.

## Foreign Currency

Our revenues, costs and expenses, and monetary assets and liabilities are exposed to changes in foreign currency exchange rates as a result of our global operating and financing activities. We hedge revenues, expenses and balance sheet exposures that are not denominated in the functional currencies of our subsidiaries on a short-term and anticipated basis on our behalf. The result of the hedging has been included in our combined and consolidated statement of operations. We do experience some fluctuations within individual lines of the combined and consolidated balance sheet and statement of operations because our hedging program is not designed to offset the currency movements in each category of revenues, expenses, monetary assets and liabilities. Our hedging program is designed to hedge currency movements on a relatively short-term basis (up to a rolling twelve-month period). Therefore, we are exposed to currency fluctuations over the longer term. To the extent that we are required to pay for all, or portions, of an acquisition price in foreign currencies, we may enter into foreign exchange contracts to reduce the risk that currency movements will impact the U.S. dollar cost of the transaction.

Prior to the Capitalization, we were under Agilent’s hedging program and none of the financial instruments used in Agilent’s hedging program were included in our combined and consolidated balance sheet.

## Results from Operations—Years ended October 31, 2014, 2013 and 2012

### Orders and Net Revenue

In general, recorded orders represent firm purchase commitments from our customers with established terms and conditions for products and services that will be delivered within six months. Revenue reflects the delivery and acceptance of the products and services as defined on the customer’s terms and conditions. Cancellations are recorded in the period received from the customer and historically have not been material.

|                              | Years Ended October 31, |          |          | 2014 over<br>2013<br>% Change | 2013 over<br>2012<br>% Change |
|------------------------------|-------------------------|----------|----------|-------------------------------|-------------------------------|
|                              | 2014                    | 2013     | 2012     |                               |                               |
| Orders . . . . .             | \$ 2,963                | \$ 2,866 | \$ 3,280 | 3%                            | (13)%                         |
| Net revenue:                 |                         |          |          |                               |                               |
| Products . . . . .           | \$ 2,479                | \$ 2,434 | \$ 2,862 | 2%                            | (15)%                         |
| Services and other . . . . . | 454                     | 454      | 453      | —%                            | —%                            |
| Total net revenue . . . . .  | \$ 2,933                | \$ 2,888 | \$ 3,315 | 2%                            | (13)%                         |

|                              | Years Ended October 31, |      |      | 2014 over        | 2013 over        |
|------------------------------|-------------------------|------|------|------------------|------------------|
|                              | 2014                    | 2013 | 2012 | 2013 Ppts Change | 2012 Ppts Change |
| % of total net revenue:      |                         |      |      |                  |                  |
| Products . . . . .           | 85%                     | 84%  | 86%  | 1 ppt            | (2) ppt          |
| Services and other . . . . . | 15%                     | 16%  | 14%  | (1) ppt          | 2 ppt            |
| Total . . . . .              | 100%                    | 100% | 100% |                  |                  |

Total orders increased 3 percent in 2014 compared to 2013. Orders increased in all market segments including aerospace and defense; industrial, computer, and semiconductor test; and communications test. Foreign currency movements had an unfavorable impact of 1 percentage point on the year-over-year compare. Our orders declined 13 percent in 2013 compared to 2012. Orders were lower for all market segments, including aerospace and defense; industrial, computer, and semiconductor test; and communications test.

Net revenue of \$2,933 million for 2014 increased 2 percent as compared to 2013, with modest growth in industrial, computer and semiconductor test contributing 2 percentage points of the increase, and communication test contributing 1 percentage point of the increase, partially offset by a decline in aerospace and defense revenue. Foreign currency movements had an unfavorable impact of 1 percentage point on the year-over-year compare. Revenue from Asia Pacific, excluding Japan, grew 8 percent driven by growth in communication test and industrials, computer and semiconductor test. Europe revenue increased 5 percent year-over-year from growth in communications test. Americas revenues declined 3 percent year-over-year with lower aerospace and defense and communications test. Japan revenues declined 9 percent year-over-year, with declines in all market segments. Revenue from products increased 2 percent in 2014 compared to 2013 while service related revenue was flat. Revenue declined 13 percent in 2013 compared to 2012 primarily due to lower wireless manufacturing and industrial, computer and semiconductor test demand.

Communications test revenue, representing approximately 34 percent of our total revenue, increased year-over-year with increases in wireless manufacturing and broadband communications business, partially offset by modest declines in Wireless R&D. Wireless manufacturing growth continues to be driven by 4G base station investments, mainly for China. Broadband showed solid growth impacted by demand for datacom bandwidth. Wireless R&D continues to be affected by cautious customer spending driven by consolidation and restructuring activities throughout the industry, across device, network equipment, chipset and component manufacturers. In 2013, communications test revenue declined compared to 2012 due to significantly lower wireless manufacturing demand and modest declines in wireless R&D.

Aerospace and defense business, representing approximately 22 percent of our total revenue, decreased compared to 2013, with declines in all regions, however we saw positive growth in the last half of fiscal 2014. In 2013, aerospace and defense test, representing approximately 23 percent of total revenue, was flat compared to 2012, with lower demand in the Americas offset by stronger spending in Europe.

Industrial, computer and semiconductor test revenue, representing approximately 44 percent of total business, increased year-over-year compared to 2013. The computer and semiconductor increase was driven by investment in capacity growth and the overall strength in the semiconductor market. The industrial test business grew for the year with particular strength in the last fiscal quarter driven by growth in the Americas and Asia Pacific, excluding Japan. In 2012, industrial, computer and semiconductor test represented approximately 43 percent of the total business with slight growth in computer and semiconductor business.

## Backlog

Backlog represents the amount of revenue expected from orders that have already been booked, including orders for goods and services that have not been delivered to customers, orders invoiced but not yet recognized as revenue, and orders for goods that were shipped but not invoiced, awaiting acceptance by customers.

At October 31, 2014, our unfilled backlog was approximately \$781 million as compared to approximately \$761 million at October 31, 2013. For the measurement solutions business, our unfilled backlog was approximately \$627 million at October 31, 2014 as compared to approximately \$563 million at October 31, 2013. Within our customer services and support business, our unfilled backlog was approximately \$154 million at October 31, 2014 as compared to approximately \$198 million at October 31, 2013. The reduction in the customer services and support business backlog in fiscal 2014 was primarily due to a change in our standard warranty term, which increased from one to three years for most of our products in the second quarter of fiscal 2013. Revenue associated with extended warranties, which provide coverage beyond the standard warranty term, is deferred and amortized over the extended period of coverage. As a result of the extension of the standard warranty term, backlog associated with extended warranties has declined. Three year warranty is now included as part of the total solution, and the value is captured as part of the system sale.

We expect that a majority of the unfilled backlog will be recognized as revenue within six months. On average, our unfilled backlog represents approximately three months' worth of revenue. We believe backlog on any particular date, while indicative of short-term revenue performance, is not necessarily a reliable indicator of medium or long-term revenue performance.

## Costs and Expenses

|  | Years Ended October 31, |        |        | 2014 over<br>2013<br>Change | 2013 over<br>2012<br>Change |
|--|-------------------------|--------|--------|-----------------------------|-----------------------------|
|  | 2014                    | 2013   | 2012   |                             |                             |
| Gross margin on products . . . . .       | 56.3%                   | 57.1%  | 57.8%  | (1) ppt                     | (1) ppt                     |
| Gross margin on services and other       | 49.4%                   | 51.3%  | 50.1%  | (2) ppt                     | 1 ppt                       |
| Total gross margin . . . . .             | 55.2%                   | 56.2%  | 56.7%  | (1) ppt                     | (1) ppt                     |
| Operating margin . . . . .               | 16.0%                   | 17.2%  | 22.1%  | (1) ppt                     | (5) ppts                    |
| <u>(in millions)</u>                     |                         |        |        |                             |                             |
| Research and development . . . . . \$    | 361                     | \$ 375 | \$ 377 | (4)%                        | (1)%                        |
| Selling, general and administrative . \$ | 790                     | \$ 752 | \$ 771 | 5%                          | (2)%                        |

Gross margin declined 1 percentage point in 2014 compared to 2013 on slightly higher revenue. Higher inventory charges and pricing pressure in the wireless manufacturing market were the primary reasons for the lower gross margin. Gross margin declined 1 percentage point in 2013 compared to 2012 primarily due to lower sales volume, while declines in variable and incentive pay and reduced infrastructure spending were offset by higher excess and obsolete inventory charges, wage increases, acquisition and integration costs, and restructuring expenses.

Excess and obsolete inventory charges were \$33 million in 2014, \$21 million in 2013 and \$14 million in 2012. Sales of previously written-down inventory were \$1 million in each of 2014, 2013 and 2012.

Research and development expenses declined 4 percent in 2014 compared to 2013 primarily due to lower infrastructure-related expenses. Research and development expenses declined 1 percent in 2013 compared to 2012. Reductions in development spending, variable and incentive pay, and infrastructure-related expenses, and the favorable impact of currency movements were partially offset by investments in acquisitions and wage increases.

Selling, general and administrative expenses increased 5 percent in 2014 compared to 2013 primarily due to higher costs related to non-recurring pre-separation transaction costs and an increase in marketing expenses, partially offset by reductions in infrastructure costs and the favorable impact of currency movements. Selling, general and administrative expenses decreased 2 percent in 2013 compared to 2012. Reductions in discretionary spending, lower variable and incentive pay, and the favorable impact of currency movements were partially offset by wage increases.

Operating margins declined 1 percentage point in 2014 compared to 2013 primarily driven by one-time separation costs. Operating margins declined by 5 percentage points in 2013 compared to 2012 on lower revenue partially offset by reduced operating expenses. As of October 31, 2014, our headcount was approximately 9,600.

## Income Taxes

|  | Years Ended October 31, |               |         |
|--|-------------------------|---------------|---------|
|  | 2014                    | 2013          | 2012    |
|  |                         | (in millions) |         |
| Provision (benefit) for income taxes . . . . . | \$ 83                   | \$ 44         | \$ (95) |

For 2014, the effective tax rate was 18 percent. The 18 percent effective tax is lower than the U.S. statutory rate primarily due to the mix of earnings in non-U.S. jurisdictions taxed at lower statutory tax rates; in particular Singapore, where we enjoyed tax holidays for the first three quarters of 2014, which resulted in a decrease to income tax expense of \$40 million. The current year rate was also favorably impacted by a \$55 million benefit from a prior year reserve release, which was offset by \$62M tax expense as a result of the repatriation of foreign earnings.

For 2013, the effective tax rate was 9 percent. The 9 percent effective tax is lower than the U.S. statutory rate primarily due to the mix of earnings in non-U.S. jurisdictions taxed at lower statutory tax rates; in particular Singapore where we enjoy tax holidays.

For 2012, the effective tax rate was 13 percent. The 13 percent effective tax rate reflects tax on earnings in jurisdictions that have low effective tax rates and includes a \$227 million tax benefit due to the reversal of a valuation allowance for our U.S. federal deferred tax assets. Valuation allowances require an assessment of both positive and negative evidence when determining whether it is more likely than not that deferred tax assets are recoverable. Such assessment is required on a jurisdiction by jurisdiction basis. In the fourth quarter of 2012, management concluded that the valuation allowance for our U.S. federal deferred tax assets is no longer needed primarily due to the emergence from cumulative losses in recent years, the return to sustainable U.S. operating profits and the expectation of sustainable profitability in future periods. As of October 31, 2012, the cumulative positive evidence outweighed the negative evidence regarding the likelihood that most of the deferred tax asset for our U.S. combined income tax group will be realized. Accordingly, we recognized a non-recurring tax benefit of \$227 million in 2012 relating to the valuation allowance reversal. The effective tax rate also included a non-recurring tax expense of \$80 million relating to an increase in the overall residual tax expected to be imposed upon the repatriation of unremitted foreign earnings previously considered permanently reinvested. During the fourth quarter of 2012, we assessed the forecasted cash needs and the overall financial position of our foreign subsidiaries and determined that a portion of previously permanently reinvested earnings would no longer be reinvested overseas.

We enjoyed tax holidays in several different jurisdictions, most significantly in Singapore through the third quarter of fiscal 2014, and several jurisdictions have granted or are anticipated to grant us tax incentives that require renewal at various times in the future, most significant being in Singapore. The tax holidays provide lower rates of taxation on certain classes of income and require various thresholds of investments and employment or specific types of income in those jurisdictions. The tax holidays are due for



renewal between 2015 and 2023. As a result of the incentives, the impact of the tax holidays decreased income taxes by \$40 million, \$68 million and \$96 million in 2014, 2013, and 2012, respectively.

In accordance with the guidance on the accounting for uncertainty in income taxes, for all U.S. and other tax jurisdictions, we recognize potential liabilities for anticipated tax audit issues based on our estimate of whether, and the extent to which, additional taxes and interest will be due. If our estimate of income tax liabilities proves to be less than the ultimate assessment, a further charge to expense would be required. If events occur and the payment of these amounts ultimately proves to be unnecessary, the reversal of the liabilities would result in tax benefits being recognized in the period when we determine the liabilities are no longer necessary. We include interest and penalties related to unrecognized tax benefits within the provision for income taxes in the combined and condensed statements of operations.

In the United States, Agilent's tax years remain open back to the year 2008 for federal income tax purposes and the year 2000 for significant states. On January 29, 2014 Agilent reached an agreement with the IRS for the tax years 2006 through 2007 that, in the first quarter of fiscal 2014, resulted in \$55 million of tax benefit associated with the recognition of previously unrecognized U.S. federal and state tax benefits and the reversal of the related interest accruals resulting from this agreement. Agilent's U.S. federal income tax returns for 2008 through 2011 are currently under audit by the IRS. In other major jurisdictions where we conduct business, the tax years generally remain open back to the year 2003. With these jurisdictions and the United States, 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.

We have calculated our taxes on a separate return basis. However, the amounts recorded are not necessarily representative of the amounts that would have been reflected in the financial statements had we been an entity that operated independently of Agilent. Consequently our future results after our separation from Agilent may be materially different from our historical results.

## Segment Overview

We have two reportable operating segments, measurement solutions and customer support and services. The measurement solutions segment is primarily the hardware and associated software businesses serving the electronic measurement market. The customer support and services segment provides repair and calibration of the hardware measurement solutions and the resale of used instrument equipment.

## Measurement Solutions Business

Our measurement solutions business provides electronic measurement instruments and systems with related software and software design tools that are used in the design, development, manufacture, installation, deployment and operation of electronics equipment. We provide start-up assistance, consulting, optimization and application support throughout the customer's product lifecycle. Our electronic measurement solutions serve the following markets: communications test, aerospace and defense test, and industrial, computer and semiconductor test.

### *Net Revenue*

|                             | Years Ended October 31, |               |          | 2014 over<br>2013<br>Change | 2013 over<br>2012<br>Change |
|-----------------------------|-------------------------|---------------|----------|-----------------------------|-----------------------------|
|                             | 2014                    | 2013          | 2012     |                             |                             |
|                             |                         | (in millions) |          |                             |                             |
| Total net revenue . . . . . | \$ 2,533                | \$ 2,493      | \$ 2,942 | 2%                          | (15)%                       |

Measurement solutions net revenue in 2014 increased 2 percent compared to 2013, with modest growth in industrial, computer and semiconductor test contributing to 2 percentage points of the increase, and communication test contributing 1 percentage point of the increase, partially offset by a decline in aerospace and defense revenue. Measurement solutions net revenue in 2013 declined 15 percent compared to 2012 primarily on lower communications test and industrial, computer and semiconductor test demand.

### ***Gross Margin and Operating Margin***

The following table shows the measurement solutions business' margins, expenses and income from operations for 2014 versus 2013, and 2013 versus 2012.

|   | Years Ended October 31, |        |        | 2014 over<br>2013<br>Change | 2013 over<br>2012<br>Change |
|---|-------------------------|--------|--------|-----------------------------|-----------------------------|
|   | 2014                    | 2013   | 2012   |                             |                             |
| Total gross margin . . . . .                  | 57.2%                   | 58.3%  | 58.0%  | (1) ppt                     | — ppt                       |
| Operating margin . . . . .                    | 18.6%                   | 18.1%  | 22.8%  | 1 ppt                       | (5) ppts                    |
| <b>(in millions)</b>                          |                         |        |        |                             |                             |
| Research and development . . . . .            | \$ 348                  | \$ 356 | \$ 367 | (2)%                        | (3)%                        |
| Selling, general and administrative . . . . . | \$ 630                  | \$ 646 | \$ 672 | (2)%                        | (4)%                        |
| Income from operations . . . . .              | \$ 472                  | \$ 451 | \$ 669 | 5%                          | (33)%                       |

Gross margin in 2014 decreased 1 percentage point when compared to 2013 primarily due to higher inventory charges and pricing pressure in the wireless manufacturing market. Gross margin in 2013 remained flat when compared to 2012 primarily due to the lower sales volume, offset by the favorable impact of a lower proportion of wireless manufacturing business.

Research and development expenses decreased 2 percent in 2014 compared to 2013 primarily driven by lower infrastructure costs. Research and development expenses decreased 3 percent in 2013 compared to 2012 primarily driven by reductions in variable and incentive pay, discretionary spending and infrastructure related expenses. We remain committed to invest in research and development and have focused our development efforts on key strategic opportunities in order to align our business with available markets.

Selling, general and administrative expenses decreased 2 percent in 2014 compared to 2013. Decreases in infrastructure costs were partially offset by increases in marketing and discretionary spending. Selling, general and administrative expenses decreased 4 percent in 2013 compared to 2012. Reductions in discretionary spending, lower variable and incentive pay, and favorable impact of currency movements were partially offset by wage increases.

Operating margin increased by 1 percentage point in 2014 compared to 2013 on higher revenue and lower operating expenses. Operating margin decreased by 5 percentage points in 2013 compared to 2012 on lower revenue partially offset by reduced operating expenses.

### ***Income from Operations***

Income from operations in 2014 increased by \$21 million or 5 percent on increased revenue of \$40 million. Income from operations in 2013 decreased by \$218 million or 33 percent on a revenue decrease of \$449 million.

### **Customer Support and Services Business**

Our customer support and services business provides repair and calibration services for our installed base measurement solutions customers and facilitates the resale of used equipment. Our customer support and services business enables our customers to maximize the value from their electronic measurement

equipment and strengthen customer loyalty. Providing these services assures a high level of instrument performance and availability while minimizing the cost of ownership and downtime.

### *Net Revenue*

|                             | Years Ended October 31, |        |        | 2014 over<br>2013<br>Change | 2013 over<br>2012<br>Change |
|-----------------------------|-------------------------|--------|--------|-----------------------------|-----------------------------|
|                             | 2014                    | 2013   | 2012   |                             |                             |
| Total net revenue . . . . . | \$ 400                  | \$ 395 | \$ 373 | 1%                          | 6%                          |

Customer support and business net revenue in 2014 increased 1 percent compared to 2013. Growth in calibration services and remarketing sales of used equipment was partially offset by declines in the equipment repair business due to a reduction in extended warranty revenue as a result of extension of the standard warranty term from one to three years, as discussed previously under “Backlog.” Customer support and services net revenue in 2013 increased 6 percent compared to 2012 on slightly higher repair and calibration services and stronger demand for remarketed equipment.

### *Gross Margin and Operating Margin*

The following table shows the customer support and services business’ margins, expenses and income from operations for 2014 versus 2013, and 2013 versus 2012.

|   | Years Ended October 31, |       |       | 2014 over<br>2013<br>Change | 2013 over<br>2012<br>Change |
|---|-------------------------|-------|-------|-----------------------------|-----------------------------|
|   | 2014                    | 2013  | 2012  |                             |                             |
| Total gross margin . . . . .                  | 46.1%                   | 48.1% | 48.2% | (2) ppts                    | —                           |
| Operating margin . . . . .                    | 21.8%                   | 23.5% | 22.0% | (2) ppts                    | 2 ppts                      |
| <i>(in millions)</i>                          |                         |       |       |                             |                             |
| Research and development . . . . .            | \$ 10                   | \$ 10 | \$ 8  | —%                          | 20%                         |
| Selling, general and administrative . . . . . | \$ 87                   | \$ 87 | \$ 90 | —%                          | (3)%                        |
| Income from operations . . . . .              | \$ 87                   | \$ 93 | \$ 82 | (6)%                        | 14%                         |

Gross margins in 2014 decreased 2 percentage points compared to 2013. Increased costs for extended warranty contracts and the service mix change with increased calibrations were the primary reasons for the lower gross margins. Gross margin in 2013 was flat compared to 2012.

Research and development expenses for customer support and services represent the segment’s share of centralized investment. Research and development expenses were flat in 2014 compared to 2013, driven mainly by our continued investment in instrument products. Research and development expenses increased 20 percent in 2013 compared to 2012 due to an increase in centralized research and development allocations.

Selling, general, and administrative expenses were flat in 2014 compared to 2013. Selling, general, and administrative expenses were 3 percent lower in 2013 compared to 2012. Reductions in discretionary spending, lower variable and incentive pay, and the favorable impact of currency movements were offset by wage increases.

Operating margins decreased by 2 percentage points in 2014 compared to 2013. Revenue growth was more than offset by the reductions in gross margins. Operating margin increased by 2 percentage points in 2013 compared to 2012 mainly due to favorable gross margin from higher revenue with slightly lower operating expenses.

### *Income from Operations*

Income from operations in 2014 decreased by \$6 million, or 6 percent on a revenue increase of \$5 million. Income from operations in 2013 increased by \$11 million or 14 percent on a revenue increase of \$22 million.

## **Financial Condition**

### *Liquidity and Capital Resources*

Historically, Agilent has provided financing, cash management and other treasury services to us. Cash transferred to and from Agilent has been recorded as intercompany payables and receivables which are reflected in Agilent net investment in the accompanying historical combined and consolidated financial statements. We believe our cash generated from operations and our ability to access capital markets and credit lines will satisfy, for at least the next twelve months, our liquidity requirements, both globally and domestically, including the following: working capital needs, capital expenditures, business acquisitions, contractual obligations, commitments, and other liquidity requirements associated with our operations.

Although the cash generated in the U.S. from future operations, including any cash and non-permanently invested earnings repatriated to the U.S., is expected to cover our normal operating requirements and debt service requirements, a substantial amount of additional cash could be required for other purposes, such as the maturity of our current and future debt obligations, any dividends that may be declared, any future stock repurchase programs and any U.S. acquisitions. If in the future, after our separation from Agilent, we encounter a significant need for liquidity domestically or at a particular location that it cannot fulfill through borrowings, equity offerings, or other internal or external sources, we may determine that cash repatriations are necessary. Repatriation could result in additional material U.S. federal and state income tax payments in future years. Such adverse consequences would occur, for example, if the transfer of cash into the U.S. is taxed and no foreign tax credit is available to offset the U.S. tax liability, resulting in higher taxes. These factors may cause us to have an overall tax rate higher than our tax rates have been in the past. We utilize a variety of funding strategies in an effort to ensure that our worldwide cash is available in the locations in which it is needed.

Our financial position as of October 31, 2014 consisted of cash and cash equivalents of \$810 million as compared to zero as of October 31, 2013. Cash of approximately \$74 million, which amount is subject to final determination as provided in the separation and distribution agreement, will be returned to Agilent. As of October 31, 2014, approximately \$598 million of our cash and cash equivalents is held outside of the U.S. in our foreign subsidiaries.

### *Net Cash Provided by Operating Activities*

Net cash provided by operating activities was \$563 million in 2014 as compared to \$566 million provided in 2013 and \$724 million provided in 2012. Agilent paid most taxes and pension contributions on our behalf. We paid net taxes of approximately \$4 million in 2014.

In 2014, accounts receivable used cash of \$25 million, provided cash of \$44 million in 2013 and used cash of \$3 million in 2012. Days' sales outstanding were 44 days in 2014, 42 days in 2013 and 43 days in 2012. Accounts payable provided cash of \$32 million in 2014, used cash of \$24 million in 2013 and used cash of \$23 million in 2012. Cash used in inventory was \$31 million in 2014, \$53 million in 2013 and \$46 million in 2012. Inventory days on-hand decreased to 137 days in 2014 compared to 143 days in 2013 and 118 days in 2012. The increase in days on-hand between 2013 and 2012 was due to the reduced shipment volume within our business.

Agilent contributed \$15 million on our behalf to our U.S. multi-employer plans in each of 2014, 2013 and 2012. Agilent contributed \$41 million, \$45 million and \$30 million to our non-U.S. multi-employer plans in 2014, 2013 and 2012, respectively. There were no contributions to the U.S. multi-employer post-retirement health care plan for the years ended October 31, 2014, 2013, and 2012, respectively. At the

Capitalization, the assets and liabilities of these plans that were allocable to Keysight employees were transferred to Keysight plans; therefore, the plans are no longer considered multi-employer plans.

#### *Net Cash Provided by/Used in Investing Activities*

Net cash used in investing activities in 2014 was \$82 million as compared to net cash used of \$85 million in 2013 and \$172 million in 2012.

Purchases of property, plant and equipment were \$70 million in 2014, \$69 million in 2013 and \$103 million in 2012. Acquisitions of businesses and intangible assets were \$11 million in 2014, \$1 million in 2013 and \$69 million in 2012. In 2012 we acquired two businesses for \$44 million along with some smaller acquisitions. We purchased investments of \$15 million in 2013, as compared to zero in 2014 and 2012. Proceeds from the sale of investment securities were zero in each of the fiscal years 2014, 2013 and 2012.

#### *Net Cash Provided by/Used in Financing Activities*

Net cash provided by financing activities in 2014 was \$335 million compared to \$481 million used in 2013 and \$552 million used in 2012, respectively. We issued senior notes of \$1.1 billion and made a repayment of capital of \$940 million to Agilent in the year ended October 31, 2014.

#### *Credit Facility*

On September 15, 2014, we entered into a five-year credit agreement, which provides for a \$300 million unsecured credit facility that will expire on November 1, 2019. The company may use amounts borrowed under the facility for general corporate purposes. As of October 31, 2014, the company has no borrowings outstanding under the facility. We were in compliance with the covenants of the credit facility during the year ended October 31, 2014.

#### *Short-term debt*

On July 10, 2014, our wholly owned subsidiary in India entered into a short-term loan agreement with a financial institution, which provided up to \$50 million of unsecured borrowings. On July 25, 2014, we borrowed \$35 million against the loan agreement at an interest rate of 9.95 percent per annum. The loan was repaid during the year and as of October 31, 2014, no balance was outstanding.

#### *Long-term debt*

In October 2014, the company issued an aggregate principal amount of \$500 million in senior notes (“2019 senior notes”). The 2019 senior notes were issued at 99.902% of their principal amount. The notes will mature on October 30, 2019, and bear interest at a fixed rate of 3.30% per annum. The interest is payable semi-annually on April 30 and October 30 of each year, commencing on April 30, 2015.

In October 2014, the company issued an aggregate principal amount of \$600 million in senior notes (“2024 senior notes”). The 2024 senior notes were issued at 99.966% of their principal amount. The notes will mature on October 30, 2024, and bear interest at a fixed rate of 4.55% per annum. The interest is payable semi-annually on April 30 and October 30 of each year, commencing on April 30, 2015.

#### *Off Balance Sheet Arrangements and Other*

We have contractual commitments for non-cancellable operating leases. See Note 17, “Commitments and Contingencies,” to our combined and consolidated financial statements for further information on our non-cancellable operating leases.

Our liquidity is affected by many factors, some of which are based on normal ongoing operations of our business and some of which arise from fluctuations related to global economics and markets. Our cash balances are generated and held in many locations throughout the world. Local government regulations

may restrict our ability to move cash balances to meet cash needs under certain circumstances. We do not currently expect such regulations and restrictions to impact our ability to pay vendors and conduct operations throughout our global organization.

*Contractual Commitments*

Our cash flows from operations are dependent on a number of factors, including fluctuations in our operating results, accounts receivable collections, inventory management, and the timing of tax and other payments. As a result, the impact of contractual obligations on our liquidity and capital resources in future periods should be analyzed in conjunction with such factors.

The following table summarizes our total contractual obligations at October 31, 2014 for operations and excludes amounts recorded in our combined and consolidated balance sheet (in millions):

|   | <u>Less than<br/>one year</u> | <u>One to<br/>three years</u> | <u>Three to<br/>five years</u> | <u>More than<br/>five years</u> |
|---|-------------------------------|-------------------------------|--------------------------------|---------------------------------|
| Operating leases . . . . .                                    | \$ 32                         | \$ 54                         | \$ 35                          | \$ 41                           |
| Interest on senior notes . . . . .                            | 44                            | 88                            | 88                             | 136                             |
| Commitments to contract manufacturers and suppliers . . . . . | 240                           | 2                             | —                              | —                               |
| Retirement plans . . . . .                                    | 46                            | —                             | —                              | —                               |
| Other purchase commitments . . . . .                          | 33                            | —                             | —                              | —                               |
| Total . . . . .   | <u>\$ 395</u>                 | <u>\$ 144</u>                 | <u>\$ 123</u>                  | <u>\$ 177</u>                   |

*Operating leases.* Commitments under operating leases relate primarily to leasehold property, see Note 17, “Commitments and Contingencies.”

*Interest on senior notes.* We have contractual obligations for interest payments on our senior notes. Interest rates and payment dates are detailed above under “Long-term debt.”

*Commitments to contract manufacturers and suppliers.* We purchase components from a variety of suppliers and use several contract manufacturers to provide manufacturing services for our products. During the normal course of business, we issue purchase orders with estimates of our requirements several months ahead of the delivery dates. However, our agreements with these suppliers usually provide us the option to cancel, reschedule, and adjust our requirements based on our business needs prior to firm orders being placed. Typically purchase orders outstanding with delivery dates within 30 days are non-cancellable. Therefore, approximately 86% percent of our reported purchase commitments arising from these agreements are firm, non-cancellable, and unconditional commitments. We expect to fulfill most of our purchase commitments for inventory within one year.

In addition to the above-mentioned commitments to contract manufacturers and suppliers, we record a liability for firm, non-cancellable and unconditional purchase commitments for quantities in excess of our future demand forecasts consistent with our policy relating to excess inventory. As of October 31, 2014, the liability for our excess firm, non-cancellable and unconditional purchase commitments was \$5 million, compared to \$5 million as of October 31, 2013 and \$4 million as of October 31, 2012. These amounts are included in other accrued liabilities in our combined and consolidated balance sheet.

*Retirement Plans.* Commitments under the retirement plans relate to expected contributions to be made to our non-U.S. defined benefit plans and to our post-retirement medical plans for the next year only. Contributions after next year are impractical to estimate.

*Other purchase commitments.* Other purchase commitments relate to contracts with professional services suppliers. Typically we can cancel these contracts within 90 days without penalties. For those contracts that are not cancellable within 90 days without penalties, we are disclosing the amounts we are obligated to pay to a supplier under each contract in that period before such contract can be canceled. As

of October 31, 2014, our contractual obligations with these suppliers are approximately \$33 million within the next fiscal year, as compared to approximately \$26 million as of October 31, 2013. The increase is due to additional contracts associated with our pre-separation expenditures and additional contracts put in place related to our operational separation from Agilent on August 1, 2014.

We had no material off-balance sheet arrangements as of October 31, 2014 or October 31, 2013.

*On Balance Sheet Arrangements.* The following table summarizes our total contractual obligations recorded in our combined and consolidated balance sheet pertaining to our long-term debt as of October 31, 2014 (in millions):

|                        | <u>Less than<br/>one year</u> | <u>One to<br/>three years</u> | <u>Three to<br/>five years</u> | <u>More than<br/>five years</u> |
|------------------------|-------------------------------|-------------------------------|--------------------------------|---------------------------------|
| Senior notes . . . . . | \$ —                          | \$ —                          | \$ 500                         | \$ 600                          |

Other long-term liabilities include \$82 million and \$92 million of liabilities for uncertain tax positions as of October 31, 2014 and October 31, 2013, respectively. We are unable to accurately predict when these amounts will be realized or released. However, it is reasonably possible that there could be significant changes to our unrecognized tax benefits in the next 12 months due to either the expiration of a statute of limitations or a tax audit settlement.

### QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to foreign currency exchange rate risks inherent in our sales commitments, anticipated sales, and assets and liabilities denominated in currencies other than the functional currency of our subsidiaries. We hedge future cash flows denominated in currencies other than the functional currency using sales and expense forecasts up to twelve months in advance. Our exposure to exchange rate risks is managed on an enterprise-wide basis. This strategy utilizes derivative financial instruments, including option and forward contracts, to hedge certain foreign currency exposures with the intent of offsetting gains and losses that occur on the underlying exposures with gains and losses on the derivative contracts hedging them. We do not currently and do not intend to utilize derivative financial instruments for speculative trading purposes.

Our operations generate non-functional currency cash flows such as revenues, third party vendor payments and inter-company payments. In anticipation of these foreign currency cash flows and in view of volatility of the currency market, we enter into such foreign exchange contracts as are described above to manage our currency risk. Approximately 74 percent of our revenues in 2014, 75 percent of our revenues in 2013 and 76 percent of our revenues in 2012 were generated in U.S. dollars.

We performed a sensitivity analysis assuming a hypothetical 10 percent adverse movement in foreign exchange rates to the hedging contracts and the underlying exposures described above. As of October 31, 2014 and 2013, the analysis indicated that these hypothetical market movements would not have a material effect on our combined and consolidated financial position, results of operations or cash flows.

We are also exposed to interest rate risk due to the mismatch between the interest expense we pay on our loans at fixed rates and the variable rates of interest we receive from cash, cash equivalents and other short-term investments. We have issued long-term debt in U.S. dollars at fixed interest rates based on the market conditions at the time of financing. We believe that the fair value of our fixed rate debt changes when the underlying market rates of interest change, and we may use interest rate swaps to modify such market risk.

We performed a sensitivity analysis assuming a hypothetical 10 percent adverse movement in interest rates relating to the underlying fair value of our fixed rate debt. As of October 31, 2014, the sensitivity analyses indicated that a hypothetical 10 percent adverse movement in interest rates would result in an immaterial impact to the fair value of our fixed rate debt.

## **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

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

In our opinion, the combined and consolidated financial statements listed in the index appearing under Item 8 present fairly, in all material respects, the financial position of Keysight Technologies, Inc. and its subsidiaries at October 31, 2014 and October 31, 2013, and the results of their operations and their cash flows for each of the three years in the period ended October 31, 2014 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related combined and consolidated financial statements. 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 the standards of the Public Company Accounting Oversight Board (United States). Those standards 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.

/s/ PRICEWATERHOUSECOOPERS LLP

December 22, 2014



**KEYSIGHT TECHNOLOGIES, INC.**  
**COMBINED AND CONSOLIDATED STATEMENT OF OPERATIONS**

|   | Years Ended October 31,              |               |               |
|---|--------------------------------------|---------------|---------------|
|   | 2014                                 | 2013          | 2012          |
|   | (in millions, except per share data) |               |               |
| Net revenue:  |                                      |               |               |
| Products . . . . .  | \$ 2,479                             | \$ 2,434      | \$ 2,862      |
| Services and other . . . . .                              | 454                                  | 454           | 453           |
| Total net revenue . . . . .                               | <u>2,933</u>                         | <u>2,888</u>  | <u>3,315</u>  |
| Costs and expenses:                                       |                                      |               |               |
| Cost of products . . . . .                                | 1,083                                | 1,044         | 1,208         |
| Cost of services and other . . . . .                      | 230                                  | 221           | 226           |
| Total costs . . . . .                                     | <u>1,313</u>                         | <u>1,265</u>  | <u>1,434</u>  |
| Research and development . . . . .                        | 361                                  | 375           | 377           |
| Selling, general and administrative . . . . .             | 790                                  | 752           | 771           |
| Total costs and expenses . . . . .                        | <u>2,464</u>                         | <u>2,392</u>  | <u>2,582</u>  |
| Income from operations . . . . .                          | 469                                  | 496           | 733           |
| Interest expense . . . . .                                | (3)                                  | —             | —             |
| Other income (expense), net . . . . .                     | 9                                    | 5             | 13            |
| Income before taxes . . . . .                             | 475                                  | 501           | 746           |
| Provision (benefit) for income taxes . . . . .            | 83                                   | 44            | (95)          |
| Net income . . . . .                                      | <u>\$ 392</u>                        | <u>\$ 457</u> | <u>\$ 841</u> |
| Net income per share—basic and diluted(a) . . . . .       | \$ 2.35                              | \$ 2.74       | \$ 5.04       |
| Basic and diluted average shares outstanding(a) . . . . . | 167                                  | 167           | 167           |

(a) On November 1, 2014, Agilent Technologies, Inc. distributed 167 million shares of Keysight common stock to existing holders of Agilent common stock. Basic and diluted net income per share for all periods through October 31, 2014 is calculated using the shares distributed on November 1, 2014.

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

**KEYSIGHT TECHNOLOGIES, INC.**  
**COMBINED AND CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME**

|  | Years Ended October 31, |               |               |
|--|-------------------------|---------------|---------------|
|  | 2014                    | 2013          | 2012          |
|  | (in millions)           |               |               |
| Net income . . . . .   | \$ 392                  | \$ 457        | \$ 841        |
| Other comprehensive income (loss):   |                         |               |               |
| Unrealized gain on investments, net of tax (expense) of<br>\$(4), \$(3) and zero . . . . .           | 8                       | 5             | —             |
| Unrealized gain on derivative instruments, net of tax<br>(expense) of \$(2), zero and zero . . . . . | 3                       | —             | —             |
| Foreign currency translation, net of tax (expense) benefit of<br>\$1, \$(6) and zero . . . . .       | (72)                    | (75)          | (14)          |
| Net defined benefit pension cost and post-retirement plan<br>costs:                                  |                         |               |               |
| Change in actuarial net loss, net of tax benefit of \$13, zero<br>and zero . . . . .                 | (38)                    | —             | —             |
| Change in net prior service credit, net of tax benefit of \$3,<br>zero and zero . . . . .            | (5)                     | —             | —             |
| Other comprehensive loss . . . . .   | (104)                   | (70)          | (14)          |
| Total comprehensive income . . . . .   | <u>\$ 288</u>           | <u>\$ 387</u> | <u>\$ 827</u> |

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

**KEYSIGHT TECHNOLOGIES, INC.**  
**COMBINED AND CONSOLIDATED BALANCE SHEET**

|  | October 31,                                    |          |
|--|--|----------|
|  | 2014   | 2013     |
|  | (in millions, except par value and share data) |          |
| <b>ASSETS</b>  |  |          |
| Current assets:  |  |          |
| Cash and cash equivalents . . . . .  | \$ 810   | \$ —     |
| Accounts receivable, net . . . . .   | 357  | 340      |
| Receivable from Agilent . . . . .  | 23   | —        |
| Inventory . . . . .  | 498  | 502      |
| Deferred tax assets . . . . .  | 83   | 65       |
| Other current assets . . . . .   | 79   | 65       |
| Total current assets . . . . .   | 1,850  | 972      |
| Property, plant and equipment, net . . . . .   | 470  | 469      |
| Goodwill . . . . .   | 392  | 419      |
| Other intangible assets, net . . . . .   | 18   | 20       |
| Long-term investments . . . . .  | 63   | 44       |
| Long-term deferred tax assets . . . . .  | 163  | 88       |
| Other assets . . . . .   | 94   | 16       |
| Total assets . . . . .   | \$ 3,050                                       | \$ 2,028 |
| <b>LIABILITIES AND EQUITY</b>  |  |          |
| Current liabilities:   |  |          |
| Accounts payable . . . . .   | \$ 173   | \$ 131   |
| Payable to Agilent . . . . .   | 125  | —        |
| Employee compensation and benefits . . . . .   | 167  | 142      |
| Deferred revenue . . . . .   | 175  | 190      |
| Income and other taxes payable . . . . .   | 72   | 55       |
| Other accrued liabilities . . . . .  | 57   | 42       |
| Total current liabilities . . . . .  | 769  | 560      |
| Long-term deferred revenue . . . . .   | 69   | 94       |
| Long-term debt . . . . .   | 1,099  | —        |
| Retirement and post-retirement benefits . . . . .  | 213  | —        |
| Other long-term liabilities . . . . .  | 131  | 129      |
| Total liabilities . . . . .  | 2,281  | 783      |
| Commitments and contingencies (Note 17)  |  |          |
| Stockholders' equity:  |  |          |
| Agilent net investment . . . . .   | —  | 1,214    |
| Common stock; \$0.01 par value; 1 billion shares authorized; 167 million shares issued and outstanding at October 31, 2014, and no shares issued and outstanding at October 31, 2013 . . . . . | 2  | —        |
| Additional paid-in-capital . . . . .   | 1,002  | —        |
| Retained earnings . . . . .  | 101  | —        |
| Accumulated other comprehensive income (loss) . . . . .  | (336)  | 31       |
| Total stockholders' equity . . . . .   | 769  | 1,245    |
| Total liabilities and equity . . . . .   | \$ 3,050                                       | \$ 2,028 |

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

**KEYSIGHT TECHNOLOGIES, INC.**  
**COMBINED AND CONSOLIDATED STATEMENT OF CASH FLOWS**

|   | Years Ended October 31, |              |              |
|---|-------------------------|--------------|--------------|
|   | 2014                    | 2013         | 2012         |
|   | (in millions)           |              |              |
| Cash flows from operating activities:   |                         |              |              |
| Net income . . . . .  | \$ 392                  | \$ 457       | \$ 841       |
| Adjustments to reconcile net income to net cash provided by operating activities: |                         |              |              |
| Depreciation and amortization . . . . .   | 84                      | 77           | 65           |
| Share-based compensation . . . . .  | 43                      | 41           | 38           |
| Excess tax benefit on share based plans . . . . .                                 | (4)                     | —            | —            |
| Deferred taxes . . . . .  | 23                      | 14           | (118)        |
| Excess and obsolete inventory . . . . .   | 33                      | 21           | 14           |
| Asset impairment charges . . . . .  | —                       | 1            | —            |
| Other, net . . . . .  | (1)                     | 1            | 1            |
| Changes in assets and liabilities:  |                         |              |              |
| Accounts receivable, net . . . . .  | (25)                    | 44           | (3)          |
| Inventory . . . . .   | (31)                    | (53)         | (46)         |
| Accounts payable . . . . .  | 32                      | (24)         | (23)         |
| Related party, net . . . . .  | 23                      | —            | —            |
| Employee compensation and benefits . . . . .                                      | 30                      | —            | (32)         |
| Income and other taxes payable . . . . .  | 63                      | (2)          | (5)          |
| Other assets and liabilities . . . . .  | (99)                    | (11)         | (8)          |
| Net cash provided by operating activities . . . . .                               | <u>563</u>              | <u>566</u>   | <u>724</u>   |
| Cash flows from investing activities:   |                         |              |              |
| Purchases of property, plant and equipment . . . . .                              | (70)                    | (69)         | (103)        |
| Acquisitions of businesses and intangible assets, net of cash acquired . . . . .  | (11)                    | (1)          | (69)         |
| Purchase of investments . . . . .   | —                       | (15)         | —            |
| Change in restricted cash, cash equivalents and investments . . . . .             | (2)                     | —            | —            |
| Other . . . . .   | 1                       | —            | —            |
| Net cash used in investing activities . . . . .                                   | <u>(82)</u>             | <u>(85)</u>  | <u>(172)</u> |
| Cash flows from financing activities:   |                         |              |              |
| Issuance of senior notes . . . . .  | 1,099                   | —            | —            |
| Debt issuance costs . . . . .   | (10)                    | —            | —            |
| Proceeds from short term borrowings . . . . .                                     | 2                       | —            | —            |
| Repayment of debts and credit facility . . . . .                                  | (37)                    | —            | —            |
| Excess tax benefit from share-based plans . . . . .                               | 4                       | —            | —            |
| Return of capital to Agilent . . . . .  | (940)                   | —            | —            |
| Net transfers from (to) Agilent . . . . .   | 217                     | (481)        | (552)        |
| Net cash provided by (used in) financing activities . . . . .                     | <u>335</u>              | <u>(481)</u> | <u>(552)</u> |
| Effect of exchange rate movements . . . . .                                       | (6)                     | —            | —            |
| Net increase in cash and cash equivalents . . . . .                               | 810                     | —            | —            |
| Cash and cash equivalents at beginning of year . . . . .                          | —                       | —            | —            |
| Cash and cash equivalents at end of year . . . . .                                | <u>\$ 810</u>           | <u>\$ —</u>  | <u>\$ —</u>  |

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

**KEYSIGHT TECHNOLOGIES, INC.**  
**COMBINED AND CONSOLIDATED STATEMENT OF EQUITY**

|  | Common Stock  |           |                            | Retained Earnings | Accumulated Other Comprehensive Income/(Loss) | Agilent Net Investment | Total Equity |
|--|---|-----------|----------------------------|-------------------|---|------------------------|--------------|
|  | Number of Shares                                    | Par Value | Additional Paid-in Capital |                   |   |                        |              |
|  | (in millions, except number of shares in thousands) |           |                            |                   |   |                        |              |
| Balance as of October 31, 2011 . . . . .   | —   | \$ —      | \$ —                       | \$ —              | \$ 115  | \$ 881                 | \$ 996       |
| Components of comprehensive income, net of tax:  |   |           |                            |                   |   |                        |              |
| Net income . . . . .   | —   | —         | —                          | —                 | —   | 841                    | 841          |
| Other comprehensive loss . . . . .   | —   | —         | —                          | —                 | (14)  | —                      | (14)         |
| Total comprehensive income . . . . .   |   |           |                            |                   |   |                        | 827          |
| Net transfers to Agilent . . . . .   | —   | —         | —                          | —                 | —   | (518)                  | (518)        |
| Balance as of October 31, 2012 . . . . .   | —   | \$ —      | \$ —                       | \$ —              | \$ 101  | \$ 1,204               | \$ 1,305     |
| Components of comprehensive income, net of tax:  |   |           |                            |                   |   |                        |              |
| Net income . . . . .   | —   | —         | —                          | —                 | —   | 457                    | 457          |
| Other comprehensive loss . . . . .   | —   | —         | —                          | —                 | (70)  | —                      | (70)         |
| Total comprehensive income . . . . .   |   |           |                            |                   |   |                        | 387          |
| Net transfers to Agilent . . . . .   | —   | —         | —                          | —                 | —   | (447)                  | (447)        |
| Balance as of October 31, 2013 . . . . .   | —   | \$ —      | \$ —                       | \$ —              | \$ 31   | \$ 1,214               | \$ 1,245     |
| Components of comprehensive income, net of tax:  |   |           |                            |                   |   |                        |              |
| Net income (pre-capitalization) . . . . .  | —   | —         | —                          | —                 | —   | 291                    | 291          |
| Net income (post-capitalization) . . . . .   | —   | —         | —                          | 101               | —   | —                      | 101          |
| Total net income . . . . .   |   |           |                            |                   |   |                        | 392          |
| Other comprehensive loss (pre-capitalization) . . . . .  | —   | —         | —                          | —                 | (8)   | —                      | (8)          |
| Other comprehensive loss (post-capitalization) . . . . .   | —   | —         | —                          | —                 | (96)  | —                      | (96)         |
| Total other comprehensive loss . . . . .   |   |           |                            |                   |   |                        | (104)        |
| Total comprehensive income . . . . .   |   |           |                            |                   |   |                        | 288          |
| Net transfers to Agilent (pre-capitalization) . . . . .  | —   | —         | —                          | —                 | —   | (267)                  | (267)        |
| Transfers due to Capitalization . . . . .  | —   | —         | —                          | —                 | (263)   | 780                    | 517          |
| Return of capital to Agilent (post-capitalization) . . . . .   | —   | —         | —                          | —                 | —   | (900)                  | (900)        |
| Excess cash paid or payable to Agilent . . . . .   | —   | —         | —                          | —                 | —   | (114)                  | (114)        |
| Issuance of common stock and reclassification of parent company investment in connection with separation . . . . . | 167,483   | 2         | 1,002                      | —                 | —   | (1,004)                | —            |
| Balance as of October 31, 2014 . . . . .   | 167,483   | \$ 2      | \$ 1,002                   | \$ 101            | \$ (336)                                      | \$ —                   | \$ 769       |

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

**KEYSIGHT TECHNOLOGIES, INC.**  
**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS**

**1. OVERVIEW AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Overview.* Keysight Technologies, Inc. (“we”, “us”, “Keysight” or the “company”), incorporated in Delaware on December 6, 2013, is a measurement company providing core electronic measurement solutions to communications and electronics industries.

On November 1, 2014, Keysight became an independent publicly-traded company through the distribution by Agilent Technologies Inc. (“Agilent”) of 100 percent of the outstanding common stock of Keysight to Agilent’s shareholders (the “Separation”). Each Agilent shareholder of record as of the close of business on October 22, 2014 received one share of Keysight common stock for every two shares of Agilent common stock held on the record date. Approximately 167 million shares of Keysight common stock were distributed on November 1, 2014 to Agilent shareholders. Keysight’s Registration Statement on Form 10 was declared effective by the U.S. Securities and Exchange Commission (“SEC”) on October 6, 2014. Keysight’s common stock began trading “regular-way” under the ticker symbol “KEYS” on the New York Stock Exchange on November 3, 2014.

*Basis of presentation and separation from Agilent.* Prior to the distribution, Agilent transferred substantially all of the assets and liabilities and operations of the electronic measurement business to Keysight in August 2014 (“the Capitalization”). Combined financial statements prior to the Capitalization were prepared on a stand-alone basis and were derived from Agilent’s consolidated financial statements and accounting records. The combined financial statements reflect our financial position, results of operations, comprehensive income and cash flows as our business was operated as part of Agilent prior to the Capitalization. Following the Capitalization the consolidated financial statements include the accounts of the company and our wholly-owned subsidiaries. All periods have been accounted for in conformity with U.S. generally accepted accounting principles (“GAAP”).

For periods prior to the Capitalization, the combined and consolidated financial statements include the allocation of certain assets and liabilities that were historically held at the Agilent level but which were specifically identified or allocated to us. Cash and cash equivalents held by Agilent were not allocated to us. Agilent’s debt and related interest expense were not allocated to us since we were not the legal obligor of the debt and Agilent’s borrowings were not directly attributable to us. In addition, prior to the Capitalization, all intercompany transactions between us and Agilent were considered to be effectively settled at the time the transactions were recorded. All cash generated by our business was assumed to be remitted to the Agilent subsidiary located in the same legal entity or country. The total net effect of the settlement of these intercompany transactions prior to the Capitalization is reflected in the combined and consolidated statement of cash flows as a financing activity and in the combined and consolidated balance sheet as Agilent net investment. Our fiscal year end is October 31, and our fiscal quarters end on January 31, April 30 and July 31. Unless otherwise stated, all years and dates refer to our fiscal year.

We received significant management and shared administrative services from Agilent and we and Agilent engage in certain intercompany transactions. The combined and consolidated financial statements include allocation of certain Agilent corporate expenses, including information technology resources and support; finance, accounting, and auditing services; real estate and facility management services; human resources activities; certain procurement activities; treasury services, legal advisory services and costs for research and development. In addition, other costs allocated to us include restructuring costs, share-based compensation expense and retirement plan expenses related to Agilent’s corporate and shared services employees. These costs have been allocated to us on the basis of direct usage when identifiable, with the remainder allocated on a pro-rata basis of revenue, square footage, headcount or other measures.

## KEYSIGHT TECHNOLOGIES, INC.

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### 1. OVERVIEW AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Management believes the assumptions and allocations underlying the combined and consolidated financial statements are reasonable and appropriate. The expenses and cost allocations have been determined on a basis that Agilent and we consider to be a reasonable reflection of the utilization of services provided or the benefit received by us during the periods presented.

However, the amounts recorded for these transactions and allocations are not necessarily representative of the amounts that would have been reflected in the financial statements had we been an entity that operated independently of Agilent. Consequently, our future results of operations after our separation from Agilent will include costs and expenses for us to operate as an independent company, and these costs and expenses may be materially different from our historical results of operations, statement of comprehensive income, financial position, and cash flows. Accordingly, the financial statements for these periods are not indicative of our future results of operations, financial position, and cash flows.

Management is responsible for the fair presentation of the accompanying combined and consolidated financial statements, prepared in accordance with U.S. GAAP, and has full responsibility for their integrity and accuracy. In the opinion of management, the accompanying combined and consolidated financial statements contain all adjustments necessary to present fairly our combined and consolidated balance sheet, statement of operations, statement of comprehensive income, statement of cash flows and statement of equity for all periods presented.

*Principles of consolidation.* The combined and consolidated financial statements include the accounts of the company and our wholly- and majority-owned subsidiaries. All significant inter-company transactions have been eliminated. All significant transactions between us and other businesses of Agilent are included in these combined and consolidated financial statements. All inter-company transactions prior to the Capitalization are considered to be effectively settled for cash in the combined and consolidated statement of cash flows at the time the transaction is recorded.

*Agilent net investment.* This balance represents the accumulation of our net earnings before our separation from Agilent, including share-based compensation expense recorded, cash transferred to and from Agilent, and net inter-company receivable/payable between us and Agilent.

*Use of estimates.* The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in our combined and 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, allocated expenses from Agilent and the related allocation methods, including share-based compensation and retirement and post-retirement plan assumptions, restructuring, valuation of goodwill and accounting for income taxes.

*Revenue recognition.* We enter into agreements to sell products (hardware and/or software), services and other arrangements (multiple-element arrangements) that include combinations of products and services.

We recognize revenue, net of trade discounts and allowances, provided that (1) persuasive evidence of an arrangement exists, (2) delivery has occurred, (3) the price is fixed or determinable and (4) collectability

## KEYSIGHT TECHNOLOGIES, INC.

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### 1. OVERVIEW AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

is reasonably assured. Delivery is considered to have occurred when title and risk of loss have transferred to the customer, for products, or when the service has been provided. We consider the price to be fixed or determinable when the price is not subject to refund or adjustments. We consider arrangements with extended payment terms not to be fixed or determinable, and accordingly we defer revenue until amounts become due. At the time of the transaction, we evaluate the creditworthiness of our customers to determine the appropriate timing of revenue recognition.

*Product revenue.* Our product revenue is generated predominantly from the sales of various types of test equipment and associated software. Product revenue, including sales to resellers and distributors, is reduced for estimated returns, when appropriate. For sales or arrangements that include customer-specified acceptance criteria, including those where acceptance is required upon achievement of performance milestones, 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.

Where software is licensed separately, revenue is recognized when the software is delivered and has been transferred to the customer or, in the case of electronic delivery of software, when the customer is given access to the licensed software programs.

We also evaluate whether collection of the receivable is probable, the fee is fixed or determinable and whether any other undelivered elements of the arrangement exist on which a portion of the total fee would be allocated based on vendor-specific objective evidence (“VSOE”).

*Service revenue.* Revenue from services includes repair and calibration services, extended warranty, customer and software support, consulting, training and education. Service revenue is deferred and recognized over the contractual period or as services are rendered and accepted by the customer. For example, customer support contracts are recognized ratably over the contractual period, while training revenue is recognized as the training is provided to the customer. In addition, the four revenue recognition criteria described above must be met before service revenue is recognized.

*Revenue recognition for arrangements with multiple deliverables.* Our multiple-element arrangements are generally comprised of a combination of measurement instruments, installation or other start-up services, and/or software and/or support or services. Hardware and software elements are typically delivered at the same time and revenue is recognized upon delivery once title and risk of loss pass to the customer. Delivery of installation, start-up services and other services varies based on the complexity of the equipment, staffing levels in a geographic location and customer preferences, and can range from a few days to a few months. Service revenue is deferred and recognized over the contractual period or as services are rendered and accepted by the customer. Revenue from the sale of software products that are not required to deliver the tangible product’s essential functionality are accounted for under software revenue recognition rules which require VSOE of fair value to allocate revenue in a multiple-element arrangement. Our arrangements generally do not include any provisions for cancellation, termination, or refunds that would significantly impact recognized revenue.

We have evaluated the deliverables in our multiple-element arrangements and concluded that they are separate units of accounting if the delivered item or items have value to the customer on a standalone basis and for an arrangement that includes a general right of return relative to the delivered item(s), delivery or



## KEYSIGHT TECHNOLOGIES, INC.

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### 1. OVERVIEW AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

performance of the undelivered item(s) is considered probable and substantially in our control. We allocate revenue to each element in our multiple-element arrangements based upon their relative selling prices. We determine the selling price for each deliverable based on a selling price hierarchy. The selling price for a deliverable is based on VSOE if available, third-party evidence (“TPE”) if VSOE is not available, or estimated selling price (“ESP”) if neither VSOE nor TPE is available. Revenue allocated to each element is then recognized when the basic revenue recognition criteria for that element have been met.

We use VSOE of selling price in the selling price allocation in all instances where it exists. VSOE of selling price for products and services is determined when a substantial majority of the selling prices fall within a reasonable range when sold separately. TPE of selling price can be established by evaluating largely interchangeable competitor products or services in standalone sales to similarly situated customers. As our products contain a significant element of proprietary technology and the solution offered differs substantially from that of competitors, it is difficult to obtain the reliable standalone competitive pricing necessary to establish TPE. ESP represents the best estimate of the price at which we would transact a sale if the product or service were sold on a standalone basis. We determine ESP for a product or service by using historical selling prices which reflect multiple factors including, but not limited to, customer type, geography, market conditions, competitive landscape, gross margin objectives and pricing practices. The determination of ESP is made through consultation with and approval by management. We may modify or develop new pricing practices and strategies in the future. As these pricing strategies evolve, changes may occur in ESP. The aforementioned factors may result in a different allocation of revenue to the deliverables in multiple-element arrangements, which may change the pattern and timing of revenue recognition for these elements but will not change the total revenue recognized for the arrangement.

*Deferred revenue.* Deferred revenue represents the amount that is allocated to undelivered elements in multiple-element arrangements. We limit the revenue recognized to the amount that is not contingent on the future delivery of products or services or meeting other specified performance conditions. In addition, service revenue is deferred and recognized over the contractual period or as services are rendered and accepted by the customer.

*Accounts receivable, net.* Trade accounts receivable are recorded at the invoiced amount and do not bear interest. Such accounts receivable have been reduced by an allowance for doubtful accounts, which is our best estimate of the amount of probable credit losses in our existing accounts receivable. We determine the allowance based on customer specific experience and the aging of such receivables, among other factors. The allowance for doubtful accounts as of October 31, 2014 and 2013 was not material. We do not have any off-balance-sheet credit exposure related to our customers. Accounts receivable are also recorded net of product returns.

*Share-based compensation.* Our employees have historically participated in Agilent’s various incentive award plans, including employee stock options, restricted stock units and the employee stock purchases made under Agilent’s Employee Stock Purchase Plan (“ESPP”). Prior to our separation from Agilent, we participated in Agilent’s share-based compensation plans and recorded share-based compensation expense based on the equity awards granted to our employees. We recorded compensation expense based on expenses for the awards to our employees as well as an allocation of Agilent’s corporate and shared services employee expenses.

## KEYSIGHT TECHNOLOGIES, INC.

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### 1. OVERVIEW AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In 2014, 2013 and 2012, we accounted for share-based awards made to our employees and directors including employee stock option awards, restricted stock units, employee stock purchases made under the ESPP and performance share awards under Agilent Technologies, Inc. Long-Term Performance (“LTP”) Program using the estimated grant date fair value method of accounting. Under the fair value method, we recorded compensation expense for all share-based awards of \$44 million in 2014, \$43 million in 2013 and \$38 million in 2012.

*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. We assess the valuation of our inventory on a periodic basis and make adjustments to the value for estimated excess and obsolete inventory based on estimates about future demand and actual usage. The excess balance determined by this analysis becomes the basis for our excess inventory charge. Our excess inventory review process includes analysis of sales unit forecasts, managing product rollovers and working with manufacturing to maximize recovery of excess inventory.

*Warranty.* Our standard warranty term for most of our products from the date of delivery is typically three years, which increased from one year in the second quarter of fiscal 2013. We accrue for standard warranty costs based on historical trends in warranty charges as a percentage of net product revenue. The accrual is reviewed regularly and periodically adjusted to reflect changes in warranty cost estimates. Estimated warranty charges are recorded within cost of products at the time related product revenue is recognized. See Note 16, “Guarantees.”

We also sell extended warranties that provide warranty coverage beyond the standard warranty term. Revenue associated with extended warranties is deferred and recognized over the extended coverage period.

*Taxes on income.* Income taxes, as presented, are calculated on an “as if” separate tax return basis. Our operations have historically been included in Agilent’s U.S. federal and state income tax returns or non-U.S. jurisdiction tax returns. Agilent’s global tax model has been developed based on its entire portfolio of businesses. Accordingly, the tax results as presented are not necessarily reflective of the results that we would have generated on a standalone basis. It is possible that we will make different tax accounting elections and assertions in future periods, such as the amount of earnings that will be permanently reinvested outside the U.S. Income tax expense is based on reported income or loss before income taxes. Deferred income taxes reflect the effect of temporary differences between asset and liability amounts that are recognized for financial reporting purposes and the amounts that are recognized for income tax purposes. These deferred taxes are measured by applying currently enacted tax laws. Valuation allowances are recognized to reduce deferred tax assets to the amount that is more likely than not to be realized.

We account for uncertainty in income taxes using a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon settlement. We make adjustments to these reserves when facts and circumstances change, such as the closing of a tax audit or the refinement of an estimate due to new information. We classify the liability for unrecognized tax

## KEYSIGHT TECHNOLOGIES, INC.

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### 1. OVERVIEW AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

benefits as current to the extent that the company anticipates payment (or receipt) of cash within one year. Interest and penalties related to uncertain tax positions are recognized in the provision for income taxes.

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

*Goodwill and other 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.

The 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. Historically, we conducted our business in a single operating segment and reporting unit. In fiscal 2014, in conjunction with the planned separation, we implemented changes in our organizational structure which resulted in the formation of two reportable operating segments, which are also our reporting units. In fiscal year 2014, we assessed goodwill impairment for our two reporting units, which consisted of our two segments, Measurement Solutions and Customer Support and Services. We performed a quantitative test for goodwill impairment for both reporting units as of September 30, 2014. Based on the results of our testing, the fair value for both reporting units was significantly in excess of the carrying value. There was no impairment of goodwill during the years ended October 31, 2014, 2013 and 2012.

Other intangible assets consist primarily of developed technologies, proprietary know-how, trademarks, and customer relationships and are amortized using the straight-line method over estimated useful lives ranging from 6 months to 15 years. No impairments of purchased intangible assets were recorded during the year ended October 31, 2014, 2013 and 2012.

In July 2012, the FASB simplified the guidance for testing for impairment of indefinite-lived intangible assets other than goodwill. Our indefinite-lived intangible assets are IPR&D intangible assets. The guidance allows a qualitative approach for testing indefinite-lived intangible assets for impairment, similar to the impairment testing guidance for goodwill. It 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. The qualitative factors assist in determining whether it is more-likely-than-not (i.e. > 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

## KEYSIGHT TECHNOLOGIES, INC.

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### 1. OVERVIEW AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

any period and proceed directly to calculating its fair value. We adopted this guidance for the year ended October 31, 2012. Due to specific cancellation of an IPR&D project, we recorded an impairment of \$1 million in 2013. There were no impairments in fiscal years 2014 and 2012. In all other instances we used the qualitative test and concluded that it was more-likely-than-not that all other indefinite-lived assets were not impaired.

*Advertising.* Advertising costs are expensed as incurred and amounted to \$22 million in 2014, \$16 million in 2013 and \$18 million in 2012.

*Research and development.* Costs related to research, design and development of our products are charged to research and development expense as they are incurred.

*Sales taxes.* Sales taxes collected from customers and remitted to governmental authorities are not included in our revenue.

*Investments.* Cost method investments consisting of non-marketable equity securities are accounted for at historical cost. Trading securities are reported at fair value, with gains or losses resulting from changes in fair value recognized currently in earnings. Investments designated as available-for-sale were reported at fair value, with unrealized gains and losses, net of tax, included in accumulated other comprehensive income.

*Net income per share.* Basic net income per share is computed by dividing net income (the numerator) by the weighted average number of common shares outstanding (the denominator). The denominator for basic and diluted earnings per share for the period is based on the number of shares of Keysight common stock outstanding on the distribution date. Basic and diluted net income per share for all periods through October 31, 2014 is calculated using the shares distributed on November 1, 2014. See Note 6, "Net Income Per Share".

*Cash, cash equivalents and short term investments.* We classify investments as cash equivalents if their original maturity or remaining maturity at the time of purchase is three months or less at the date of purchase. Cash equivalents are stated at cost, which approximates fair value.

As of October 31, 2014, approximately \$598 million of our cash and cash equivalents was held outside of the U.S. in our foreign subsidiaries. Under current tax laws, most of the cash could be repatriated to the U.S., but it would be subject to U.S. federal and state income taxes, less applicable foreign tax credits. Our cash and cash equivalents mainly consist of short-term deposits held at major global financial institutions, investments in institutional money market funds, and similar short duration instruments with original maturities of 90 days or less. We continuously monitor the creditworthiness of the financial institutions and institutional money market funds in which we invest our funds.

We classify investments as short-term investments if their original maturities are greater than three months and their remaining maturities are one year or less.

*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. For those long-term equity investments accounted for under the cost or equity method, their carrying value

## KEYSIGHT TECHNOLOGIES, INC.

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### 1. OVERVIEW AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 the carrying value by approximately \$1 million as of October 31, 2014. The fair value of foreign currency contracts used for hedging purposes is estimated internally by using inputs tied to active markets. 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 12, "Fair Value Measurements," for additional information on the fair value of financial instruments.

*Concentration of credit risk.* Financial instruments that potentially subject us to significant concentration of credit risk include money market fund investments, time deposits and demand deposit balances. These investments are categorized as cash and cash equivalents and long-term investments. In addition, we have credit risk from derivative financial instruments used in hedging activities and accounts receivable. We invest in a variety of financial instruments and limit the amount of credit exposure with any one financial institution. We have a comprehensive credit policy in place and credit exposure is monitored on an ongoing basis.

Credit risk with respect to our accounts receivable is diversified due to the large number of entities comprising our customer base and their dispersion across many different industries and geographies. Credit evaluations are performed on customers requiring credit over a certain amount.

Credit risk is mitigated through collateral such as letters of credit, bank guarantees or payment terms like cash in advance. Credit evaluation is performed by an independent team to ensure proper segregation of duties. No single customer accounted for more than 10 percent of accounts receivable as of October 31, 2014 or 2013.

*Derivative instruments.* We are exposed to global foreign currency exchange rate risk in the normal course of business. We enter into foreign exchange hedging contracts, primarily forward contracts and purchased options to manage financial exposures resulting from changes in foreign currency exchange rates. Foreign currency exposures include committed and anticipated revenue and expense transactions (cash flow exposure) and assets and liabilities that are denominated in currencies other than the functional currency of the subsidiary (balance sheet exposure). For cash flow hedges, contracts are designed at inception as hedges of the related foreign currency exposures. For option contracts, we exclude time value from the measurement of effectiveness. To qualify for 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; foreign exchange hedging contracts generally mature within twelve months. In order to manage foreign currency exposures in a few limited jurisdictions we may enter into foreign exchange contracts that do not qualify for hedge accounting. In such circumstances, the local foreign currency exposure is offset by contracts owned by the parent company. We do not use derivative financial instruments for speculative trading purposes.

All derivatives are recognized on the balance sheet at their fair values. For derivative instruments that are designated and qualify as a cash flow hedge, changes in the value of the effective portion of the derivative instrument is recognized in accumulated comprehensive income, a component of stockholders' equity. Amounts associated with cash flow hedges are reclassified and recognized in income when either the forecast transaction occurs or it becomes probable the forecast transaction will not occur. Derivatives not designated as hedging instruments are recorded on the balance sheet at their fair value and changes in

## KEYSIGHT TECHNOLOGIES, INC.

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### 1. OVERVIEW AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

the fair values are recorded in the income statement in the current period. Derivative instruments are subject to master netting arrangements and qualify for net presentation in the balance sheet. Changes in the fair value of the ineffective portion of derivative instruments are recognized in earnings in the current period. Cash flows from derivative instruments are classified in the statement of cash flows in the same category as the cash flows from the hedged or economically hedged item, primarily in operating activities.

*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 the combined and consolidated statement of operations. Buildings and improvements are depreciated over the lesser of their useful lives or the remaining term of the lease and machinery and equipment over three to ten years. We use the straight-line method to depreciate assets.

*Leases.* We lease buildings, machinery and equipment under operating leases for original terms ranging generally from one to twenty-five years. Certain leases contain renewal options for periods up to ten years.

*Capitalized software.* We capitalize certain internal and external costs incurred to acquire or create internal use software. Capitalized software is included in property, plant and equipment and is depreciated over three to five years once 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 undiscounted 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.

*Restructuring costs.* The main component of our restructuring plan is related to workforce reductions. Workforce reduction charges are accrued when payment of benefits becomes probable and the amounts can be estimated. If the amounts and timing of cash flows from restructuring activities are significantly different from what we have estimated, the actual amount of restructuring and other related charges could be materially different, either higher or lower, than those we have recorded.

*Employee compensation and benefits.* Amounts owed to employees, such as accrued salary, bonuses and vacation benefits are accounted for within employee compensation and benefits. The total amount of accrued vacation benefit was \$70 million and \$58 million as of October 31, 2014 and 2013, respectively.

*Foreign currency translation.* We translate and remeasure balance sheet and income statement items into U.S. dollars. 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 at the balance sheet date; revenue and expenses are translated using monthly exchange rates which approximate to average exchange rates in effect during each period. Resulting translation adjustments are reported as a separate component of accumulated other comprehensive income (loss) in stockholders' equity.

## KEYSIGHT TECHNOLOGIES, INC.

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### 1. OVERVIEW AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 non-monetary assets and capital accounts which are remeasured at historical exchange rates. Revenue and expenses are generally remeasured at monthly exchange rates which approximate average exchange rates in effect during each period. Gains or losses from foreign currency re-measurement are included in net income. Net gains or losses resulting from foreign currency transactions, including hedging gains and losses that are allocated to us by Agilent, are reported in other income (expense), net and were zero for fiscal year 2014, a \$4 million loss for 2013 and a \$1 million loss for 2012.

*Retirement plans and post-retirement benefit plan assumptions.* Prior to the Capitalization, substantially all of our employees were covered under various defined benefit and/or defined contribution retirement plans sponsored by Agilent. All defined benefit plans and post-retirement health care plans were considered multi-employer plans. As a result, no asset or liability was recorded prior to the Capitalization to recognize the funded status in our combined and consolidated balance sheet. At the Capitalization, the assets and liabilities of these plans that were allocable to Keysight employees were transferred to Keysight plans; therefore, the plans are no longer accounted for as multi-employer plans.

Retirement and post-retirement benefit plan costs are a significant cost of doing business. They represent obligations that will ultimately be settled sometime in the future and therefore are subject to estimation. Pension accounting is intended to reflect the recognition of future benefit costs over the employees' average expected future service to Keysight based on the terms of the plans and investment and funding decisions. To estimate the impact of these future payments and our decisions concerning funding of these obligations, we are required to make assumptions using actuarial concepts within the framework of U.S. GAAP. Two critical assumptions are the discount rate and the expected long-term return on plan assets. Other important assumptions include, expected future salary increases, expected future increases to benefit payments, expected retirement dates, employee turnover, retiree mortality rates, and portfolio composition. We evaluate these assumptions at least annually. See Note 15, "Retirement Plans and Post-Retirement Pension Plans."

#### 2. NEW ACCOUNTING PRONOUNCEMENTS

In February 2013, the FASB issued 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. We adopted this guidance in the first quarter of 2014 and have presented the requisite disclosures in the combined and consolidated statement of comprehensive income and in the notes to the combined and consolidated financial statements.

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. The guidance requires that a parent de-consolidate a subsidiary or de-recognize a group of assets that is a nonprofit

## KEYSIGHT TECHNOLOGIES, INC.

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### 2. NEW ACCOUNTING PRONOUNCEMENTS (Continued)

activity or a business (other than a sale of in substance real estate or conveyance of oil and gas mineral rights) if the parent ceases to have a controlling financial interest in that group of assets. The guidance is effective for annual periods beginning on or after December 15, 2013 and interim periods within those years. We do not expect a material impact to our combined and 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 reporting periods beginning after December 15, 2013 and interim periods within those years and is consistent with our current practice.

In May 2014, the FASB issued an amendment to the accounting guidance related to revenue recognition. The amendment was the result of a joint project between the FASB and the International Accounting Standards Board (“IASB”) to clarify the principles for recognizing revenue and to develop common revenue standards for U.S. GAAP and International Financial Reporting Standards (“IFRS”). To meet those objectives, the FASB amended the FASB Accounting Standards Codification and created a new Topic 606, Revenue from Contracts with Customers, and the IASB issued IFRS 15, Revenue from Contracts with Customers. The new guidance is effective for annual periods beginning after December 15, 2016, and interim periods within those years. Early application is not permitted. We are evaluating the impact of adopting this guidance to our combined and consolidated financial statements.

In June 2014, the FASB issued an amendment to the accounting guidance relating to share-based compensation to resolve what it saw as diverse accounting treatment of certain awards. With this amendment, the FASB has given explicit guidance to treat a performance target that could be achieved after the requisite service period as a performance condition that affects vesting rather than as a non-vesting condition that affects the grant-date fair value of an award. The new guidance is effective for annual periods beginning after December 15, 2015 and for the interim periods within those annual periods. Earlier adoption is permitted. We are evaluating the impact of adopting this prospective guidance to our combined and consolidated financial statements.

In August 2014, the FASB issued guidance related to the disclosures around going concern. The standard provided guidance around management’s responsibility to evaluate whether there is substantial doubt about an entity’s ability to continue as a going concern and to provided related footnote disclosures. The standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted. We do not expect a material impact to our combined and consolidated financial statements due to the adoption of this guidance.

Other amendments to U.S. GAAP 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 combined and consolidated financial statements upon adoption.

#### 3. TRANSACTIONS WITH AGILENT

Prior to our separation, we were the Electronic Measurement segment of Agilent and thus our transactions with Agilent were considered intercompany. After our separation date, our transactions with



**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**3. TRANSACTIONS WITH AGILENT (Continued)**

Agilent are considered related party transactions since we were wholly-owned subsidiary of Agilent until October 31, 2014.

The amount of materials and services sold by us to other Agilent businesses was immaterial for the years ended October 31, 2014, 2013 and 2012 and we did not purchase any materials from the other Agilent businesses for those respective periods.

*Allocated Costs*

The combined and consolidated statement of operations includes our direct expenses for cost of products and services sold, research and development, sales and marketing, distribution, and administration as well as allocations of expenses arising from shared services and infrastructure provided by Agilent to us. These allocated expenses include costs of information technology, accounting and legal services, real estate and facilities, corporate advertising, insurance services, treasury and other corporate and infrastructure services and costs for central research and development efforts. In addition, other costs allocated to us include restructuring costs, share-based compensation expense and retirement plan expenses related to Agilent's corporate and shared services employees and are included in the table below. These expenses are allocated to us using estimates that we consider to be a reasonable reflection of the utilization of services provided to or benefits received by us. These costs have been allocated to us on the basis of direct usage when identifiable, with the remainder allocated on a pro-rata basis of revenue, square footage, headcount or other measures.

Allocated costs included in the accompanying combined statement of operations are as follows:

|   | Years ended October 31, |               |               |
|---|-------------------------|---------------|---------------|
|   | 2014                    | 2013          | 2012          |
| Cost of products and services . . . . .       | \$ 96                   | \$ 93         | \$ 98         |
| Research and development . . . . .            | 44                      | 54            | 58            |
| Selling, general and administrative . . . . . | 273                     | 257           | 246           |
| Other (income) expense . . . . .              | (4)                     | (4)           | (7)           |
| Total allocated costs . . . . .               | <u>\$ 409</u>           | <u>\$ 400</u> | <u>\$ 395</u> |

Fiscal 2014 includes allocated costs related to the period prior to the Capitalization.

*Receivable from and Payable to Agilent*

|                                   | October 31, |      |
|-----------------------------------|-------------|------|
|                                   | 2014        | 2013 |
| Receivable from Agilent . . . . . | \$ 23       | \$ — |
| Payable to Agilent . . . . .      | \$ 125      | \$ — |

Payable to Agilent at October 31, 2014 includes an accrual for return of excess cash to Agilent of approximately \$74 million, which is subject to final determination as provided in the separation and distribution agreement. Prior to the Capitalization, all intercompany transactions between us and Agilent were considered to be effectively settled at the time the transactions were recorded.

## KEYSIGHT TECHNOLOGIES, INC.

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### 3. TRANSACTIONS WITH AGILENT (Continued)

##### *Agreements with Agilent*

Prior to Capitalization, we shared and operated under agreements executed by Agilent with third parties, including but not limited to:

- purchasing, manufacturing, and freight agreements;
- the use of facilities owned, leased, and managed by Agilent; and
- software, technology and other intellectual property agreements.

#### 4. SHARE-BASED COMPENSATION

Prior to the Separation, Keysight employees participated in Agilent's stock program. The Agilent 2009 Stock Plan provides for the grant of awards in the form of stock options, stock appreciation rights ("SARs"), restricted stock, restricted stock units ("RSUs"), performance shares and performance units with performance-based conditions on vesting or exercisability, and cash awards. The 2009 Plan has a term of ten years.

The following disclosures represent the portion of Agilent's incentive stock program in which Keysight employees participated. All awards granted under the program consisted of Agilent common shares. As such, all related equity account balances are reflected in Agilent's consolidated statements of stockholders' equity and have not been reflected in Keysight's combined and consolidated financial statements. Keysight's combined and consolidated statements of earnings reflects compensation expense for these stock-based awards associated with the portion of Agilent's incentive stock program in which Keysight employees participated; accordingly, the amounts presented are not necessarily indicative of future performance and do not necessarily reflect the results that we would have experienced as an independent, publicly-traded company for the periods presented.

In conjunction with the Separation, the company adopted the Keysight Technologies, Inc. 2014 Equity and Incentive Compensation Plan (the "Plan"). Upon the Separation, the outstanding Agilent equity-based compensation awards were converted into the Keysight equity-based compensation awards issued pursuant to the Plan.

##### **Description of Keysight's Share-Based Plans**

*Incentive compensation plans.* The 2014 Equity and Incentive Compensation Plan was originally adopted by the Board on July 16, 2014, subsequently amended and restated by the Board on September 29, 2014 and became effective as of November 1, 2014 (the "Effective Date"). The Board subsequently reserved 25 million shares of Company common stock that may be issued under the 2014 Plan, plus any shares forfeited or cancelled under the Plan. The 2014 Stock Plan provides for the grant of awards in the form of stock options, SARs, restricted stock, RSUs, performance shares and performance units with performance-based conditions on vesting or exercisability, and cash awards. The 2014 Plan has a term of ten years.

Options generally vest at a rate of 25 percent per year over a period of four years from the date of grant and generally have a maximum contractual term of ten years. The exercise price for stock options is generally not less than 100 percent of the fair market value of our common stock on the date the stock award is granted. Restricted stock units generally vest at a rate of 25 percent per year over a period of four years from the date of grant.

**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**4. SHARE-BASED COMPENSATION (Continued)**

Effective November 1, 2014, the Compensation Committee of the Board of Directors approved the Performance awards plan, which is a performance stock award program administered under the 2014 Stock Plan, for the company’s executive officers and other key employees. Participants in this program are entitled to receive unrestricted shares of the company’s stock after the end of a three-year period, if specified performance targets are met. Performance awards are generally designed to meet the criteria of a performance award with the performance metrics and peer group comparison set at the beginning of the performance period. Based on the performance metrics the final award may vary from zero to 200 percent of the target award. The maximum contractual term for awards under the Performance awards program is three years. Beginning in the first quarter of fiscal 2015, we will consider the dilutive impact of this program in our diluted net income per share calculation only to the extent that the performance conditions are met.

Effective November 1, 2014, the company adopted the Employee Stock Purchase Plan (“ESPP”). The ESPP allows eligible employees to contribute up to ten percent of their base compensation to purchase shares of Keysight common stock at 85 percent of the closing market price at purchase date. Shares authorized for issuance in connection with the ESPP are subject to an automatic annual increase of the lesser of one percent of the outstanding shares of Keysight common stock on November 1, or an amount determined by the Compensation Committee of our Board of Directors. Under the terms of the ESPP, in no event shall the number of shares issued under the ESPP exceed 75 million shares.

Under Agilent’s ESPP, our employees purchased 878,816 shares for \$40 million in 2014, 764,113 shares for \$25 million in 2013 and 729,920 shares for \$25 million in 2012. The shares purchased by our employees in 2014 include the shares purchased for the second half FY 2014 ESPP purchase period. These shares were purchased one month in advance on Oct 1 2014 due to separation activities.

All equity award amounts presented below have not been converted to reflect the separation from Agilent. Subsequent to the separation on November 1, 2014, Keysight employees holding Agilent stock options, and restricted stock awards, received Keysight stock-based award in replacement of their outstanding Agilent stock based awards. The value of the replaced Keysight stock-based awards after separation was designed to generally preserve the intrinsic value and the fair value of the award immediately prior to separation. The per share data presented in this Note has not been adjusted to reflect the impact of the separation.

**Impact of Share-based Compensation Awards**

All share-based awards compensation expense has been recognized using a straight-line amortization method and as required by guidance, has been reduced for estimated forfeitures.

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

|   | Years Ended October 31, |       |       |
|---|-------------------------|-------|-------|
|   | 2014                    | 2013  | 2012  |
|   | (in millions)           |       |       |
| Cost of products and services . . . . .       | \$ 11                   | \$ 9  | \$ 8  |
| Research and development . . . . .            | 7                       | 7     | 6     |
| Selling, general and administrative . . . . . | 26                      | 27    | 24    |
| Total share-based compensation expense . . .  | \$ 44                   | \$ 43 | \$ 38 |

**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**4. SHARE-BASED COMPENSATION (Continued)**

At October 31, 2014 and 2013 there was no share-based compensation capitalized within inventory. The income tax benefit realized from the exercised stock options and similar awards recognized was \$4 million in 2014 and zero in 2013 and 2012, respectively. The weighted average grant date fair value of options, granted in 2014, 2013 and 2012 was \$18.73, \$12.18 and \$13.69 per share, respectively

**Valuation Assumptions**

For all periods presented, the fair value of share based awards for employee stock option awards was estimated using the Black-Scholes option pricing model. For all periods presented, shares granted under the LTP Program were valued using a Monte Carlo simulation. The estimated fair value of restricted stock unit awards was 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, Agilent'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 fair market value at the purchase date.

The following assumptions were used to estimate the fair value of employee stock options and LTP Program grants.

|  | <b>Years Ended October 31,</b> |             |             |
|--|--------------------------------|-------------|-------------|
|  | <b>2014</b>                    | <b>2013</b> | <b>2012</b> |
| <b>Stock Option Plans:</b>                           |                                |             |             |
| Weighted average risk-free interest rate . . . . .   | 1.69%                          | 0.86%       | 0.88%       |
| Dividend yield . . . . .                             | 1%                             | 1%          | 0%          |
| Weighted average volatility . . . . .                | 39%                            | 39%         | 38%         |
| Expected life . . . . .                              | 5.8 years                      | 5.8 years   | 5.8 years   |
| <b>LTP Program:</b>                                  |                                |             |             |
| Volatility of Agilent shares . . . . .               | —                              | 37%         | 41%         |
| Volatility of selected peer-company shares . . . . . | —                              | 6% - 64%    | 17% - 75%   |
| Price-wise correlation with selected peers . . . . . | —                              | 49%         | 62%         |

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. For all the years presented, the expected stock price volatility assumption was determined using the historical volatility of Agilent's stock options over the most recent historical period equivalent to the expected life. There were no grants made to Keysight employees under the Agilent FY14 LTP Program.

For the grants awarded under the 2009 stock plan after November 1, 2010, Agilent increased the period available to retirement eligible employees to exercise their options from three years at retirement date to the full contractual term of ten years. In developing the estimated life of our employee stock options of 5.8 years for 2012 to 2014, Agilent considered the historical option exercise behavior of the executive employees who were granted the majority of the options in the annual grants made, which they believe is representative of future behavior.

KEYSIGHT TECHNOLOGIES, INC.

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. SHARE-BASED COMPENSATION (Continued)

Share-based Payment Award Activity

Employee Stock Options

The following table summarizes employee stock option award activity as part of Agilent's annual grants for 2014:

|   | Options<br>Outstanding | Weighted<br>Average<br>Exercise Price |    |
|---|------------------------|---------------------------------------|----|
|   | (in thousands)         |                                       |    |
| Outstanding at October 31, 2013 . . . . . | 2,320                  | \$                                    | 31 |
| Granted . . . . .                         | 422                    | \$                                    | 54 |
| Exercised . . . . .                       | (1,472)                | \$                                    | 30 |
| Expired . . . . .                         | (16)                   | \$                                    | 29 |
| Employee transition(a) . . . . .          | 948                    | \$                                    | 32 |
| Outstanding at October 31, 2014 . . . . . | 2,202                  | \$                                    | 36 |

(a) Employee transition amounts consist of

- i. Option activity for employees transitioning between Agilent and Keysight.
- ii. Grants outstanding with corporate and shared services employees that were not included in grants outstanding at October 31, 2013, as they were not directly identifiable at that time.

There were no cancellations or forfeitures in 2014.

The options outstanding and exercisable for equity share-based payment awards at October 31, 2014 were as follows:

| Range of<br>Exercise Prices | Options Outstanding   |   |  |                              | Options Exercisable   |   |                                       |                              |
|-----------------------------|-----------------------|---|--|------------------------------|-----------------------|---|---------------------------------------|------------------------------|
|                             | Number<br>Outstanding | Weighted<br>Average<br>Remaining<br>Contractual<br>Life | Weighted<br>Average<br>Exercise<br>Price | Aggregate<br>Intrinsic Value | Number<br>Exercisable | Weighted<br>Average<br>Remaining<br>Contractual<br>Life | Weighted<br>Average<br>Exercise Price | Aggregate<br>Intrinsic Value |
|                             | (in thousands)        | (in years)  |  | (in thousands)               | (in thousands)        | (in years)  |                                       | (in thousands)               |
| \$0 - 25 . . . . .          | 281                   | 1.5   | \$ 20                                    | \$ 9,804                     | 281                   | 1.5   | \$ 20                                 | \$ 9,804                     |
| \$25.01 - 30 . . . . .      | 119                   | 4.4   | \$ 29                                    | 3,083                        | 119                   | 4.4   | \$ 29                                 | 3,084                        |
| \$30.01 - 40 . . . . .      | 1,380                 | 4.8   | \$ 35                                    | 28,542                       | 752                   | 2.5   | \$ 33                                 | 16,566                       |
| \$40.01 & over . . . . .    | 422                   | 9.1   | \$ 54                                    | 727                          | —                     | 0   | \$ —                                  | —                            |
|                             | 2,202                 | 5.2   | \$ 36                                    | \$ 42,156                    | 1,152                 | 2.5   | \$ 30                                 | \$ 29,454                    |

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value, based on Agilent's closing stock price of \$55.28 at October 31, 2014, which would have been received by award holders had all award holders exercised their awards that were in-the-money as of that date. The total number of in-the-money awards exercisable at October 31, 2014 was approximately 1.2 million.

**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**4. SHARE-BASED COMPENSATION (Continued)**

The following table summarizes the aggregate intrinsic value of options exercised and the fair value of options granted in 2014, 2013 and 2012:

|  | Aggregate<br>Intrinsic Value<br>(in thousands) | Weighted<br>Average<br>Exercise<br>Price | Per Share Value<br>Using<br>Black-Scholes<br>Model |
|--|--|--|--|
| Options exercised in fiscal 2012 . . .                                 | \$ 18,694                                      | \$ 22                                    |  |
| Black-Scholes per share value of<br>options granted during fiscal 2012 |  |  | \$ 14  |
| Options exercised in fiscal 2013 . . .                                 | \$ 26,808                                      | \$ 28                                    |  |
| Black-Scholes per share value of<br>options granted during fiscal 2013 |  |  | \$ 12  |
| Options exercised in fiscal 2014 . . .                                 | \$ 39,886                                      | \$ 30                                    |  |
| Black-Scholes per share value of<br>options granted during fiscal 2014 |  |  | \$ 19  |

As of October 31, 2014 the unrecognized share-based compensation costs for outstanding stock option awards, net of expected forfeitures, was approximately \$5 million, which is expected to be amortized over a weighted average period of 2.3 years. See Note 5, "Income Taxes," for the tax impact on share-based award exercises.

*Non-vested Awards*

The following table summarizes non-vested award activity in 2014 primarily for our LTP Program and restricted stock unit awards:

|  | Shares<br>(in thousands) | Weighted<br>Average Grant<br>Price |
|--|--------------------------|------------------------------------|
| Non-vested at October 31, 2013 . . . . .   | 1,086                    | \$ 37                              |
| Granted . . . . .  | 532                      | \$ 54                              |
| Vested . . . . .   | (545)                    | \$ 36                              |
| Forfeited . . . . .  | (15)                     | \$ 43                              |
| Change in LTP Program shares vested in the year<br>due to performance conditions . . . . . | (12)                     | \$ 36                              |
| Employee transition(a) . . . . .   | 376                      | \$ 37                              |
| Non-vested at October 31, 2014 . . . . .   | 1,422                    | \$ 44                              |

(a) Employee transition amounts consist of:

- i. Stock activity for employees transitioning between Agilent and Keysight.
- ii. Unvested stock with corporate and shared services employees that were not included in grants outstanding at October 31, 2013, as they were not directly identifiable at that time.

**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**4. SHARE-BASED COMPENSATION (Continued)**

As of October 31, 2014 the unrecognized share-based compensation costs for non-vested restricted stock awards, net of expected forfeitures, was approximately \$25 million, which is expected to be amortized over a weighted average period of 2.3 years. The total fair value of restricted stock awards vested was \$29 million for 2014, \$12 million for 2013 and \$12 million for 2012.

**5. INCOME TAXES**

The domestic and foreign components of income before taxes are:

|                                     | Years Ended October 31, |        |        |
|-------------------------------------|-------------------------|--------|--------|
|                                     | 2014                    | 2013   | 2012   |
|                                     | (in millions)           |        |        |
| U.S. operations . . . . .           | \$ (18)                 | \$ 14  | \$ 50  |
| Non-U.S. operations . . . . .       | 493                     | 487    | 696    |
| Total income before taxes . . . . . | \$ 475                  | \$ 501 | \$ 746 |

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

|                                      | Years Ended October 31, |       |         |
|--------------------------------------|-------------------------|-------|---------|
|                                      | 2014                    | 2013  | 2012    |
|                                      | (in millions)           |       |         |
| U.S. federal taxes:                  |                         |       |         |
| Current . . . . .                    | \$ (11)                 | \$ 10 | \$ 15   |
| Deferred . . . . .                   | 25                      | 12    | (124)   |
| Non-U.S. taxes:                      |                         |       |         |
| Current . . . . .                    | 62                      | 16    | 7       |
| Deferred . . . . .                   | (4)                     | 3     | 6       |
| State taxes, net of federal benefit: |                         |       |         |
| Current . . . . .                    | 9                       | 4     | 1       |
| Deferred . . . . .                   | 2                       | (1)   | —       |
| Total provision . . . . .            | \$ 83                   | \$ 44 | \$ (95) |

The income tax provision does not reflect potential future tax savings resulting from excess deductions associated with our various share-based award plans.

**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**5. INCOME TAXES (Continued)**

The significant components of deferred tax assets and deferred tax liabilities included in the combined and consolidated balance sheet are:

|   | October 31,            |                             |                        |                             |
|---|------------------------|-----------------------------|------------------------|-----------------------------|
|   | 2014                   |                             | 2013                   |                             |
|   | Deferred Tax<br>Assets | Deferred Tax<br>Liabilities | Deferred Tax<br>Assets | Deferred Tax<br>Liabilities |
|   | (in millions)          |                             |                        |                             |
| Inventory . . . . .   | \$ 20                  | \$ —                        | \$ 11                  | \$ (1)                      |
| Intangibles . . . . .   | 35                     | (6)                         | 9                      | —                           |
| Property, plant and equipment . . . . .                                 | 28                     | (10)                        | 11                     | (6)                         |
| Warranty reserves . . . . .   | 18                     | —                           | 12                     | —                           |
| Pension benefits . . . . .  | 61                     | (18)                        | —                      | —                           |
| Employee benefits, other than retirement . . . . .                      | 26                     | —                           | 31                     | (1)                         |
| Net operating loss, capital loss, and credit<br>carryforwards . . . . . | 127                    | —                           | 214                    | —                           |
| State taxes . . . . .   | 6                      | —                           | 3                      | —                           |
| Unremitted earnings of foreign subsidiaries . . . . .                   | —                      | (53)                        | —                      | (120)                       |
| Share-based compensation . . . . .                                      | 15                     | —                           | 8                      | —                           |
| Deferred revenue . . . . .  | 42                     | (1)                         | 11                     | (1)                         |
| Other . . . . .   | 3                      | (11)                        | 15                     | (11)                        |
| Subtotal . . . . .  | 381                    | (99)                        | 325                    | (140)                       |
| Tax valuation allowance . . . . .                                       | (39)                   | —                           | (41)                   | —                           |
| Total deferred tax assets or deferred tax<br>liabilities . . . . .      | <u>\$ 342</u>          | <u>\$ (99)</u>              | <u>\$ 284</u>          | <u>\$ (140)</u>             |

The significant increase in 2014 as compared to 2013 for the deferred tax asset relating to pension benefits is due mainly to the tax effect of changes in post-retirement pension plans recognized in other comprehensive income. Other significant changes in deferred tax assets and liabilities include a \$101 million reduction in the tax credit carryovers resulting from the utilization of U.S. tax credits in the year ended October 31, 2014 following the repatriation of foreign earnings in the first quarter of fiscal 2014, the addition of \$114 million in deferred tax assets as a result of the Separation as well as the reduction of \$70 million of unremitted earnings of foreign subsidiaries.

We record U.S. income taxes on the undistributed earnings of foreign subsidiaries unless the subsidiaries' earnings are considered permanently reinvested outside the U.S. As of October 31, 2014 we recognized a \$53 million deferred tax liability for the overall residual tax expected to be imposed upon the repatriation of unremitted foreign earnings that are not considered permanently reinvested. As of October 31, 2014 the cumulative amount of undistributed earnings considered permanently reinvested was \$4.2 billion. No deferred tax liability has been recognized on the basis difference created by such earnings since it is our intention to utilize those earnings in the company's foreign operations. Because of the availability of U.S. foreign tax credits, the determination of the unrecognized deferred tax liability on these earnings is not practicable.



**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**5. INCOME TAXES (Continued)**

The breakdown between current and long-term deferred tax assets and deferred tax liabilities was as follows for the years 2014 and 2013:

|  | October 31,   |        |
|--|---------------|--------|
|  | 2014          | 2013   |
|  | (in millions) |        |
| Current deferred tax assets . . . . .  | \$ 83         | \$ 65  |
| Long-term deferred tax assets . . . . .  | 163           | 88     |
| Current deferred tax liabilities (included within other accrued liabilities) . . . . .     | (1)           | (6)    |
| Long-term deferred tax liabilities (included within other long-term liabilities) . . . . . | (2)           | (3)    |
| Total . . . . .  | \$ 243        | \$ 144 |

Valuation allowances require an assessment of both positive and negative evidence when determining whether it is more likely than not that deferred tax assets are recoverable. Such assessment is required on a jurisdiction by jurisdiction basis. In the fourth quarter of 2012, management concluded that the valuation allowance for most of our U.S. federal and state deferred tax assets was no longer needed primarily due to the emergence from cumulative losses in recent years, the return to sustainable U.S. operating profits and the expectation of sustainable profitability in future periods. As of October 31, 2012 the cumulative positive evidence outweighed the negative evidence regarding the likelihood that most of the deferred tax asset for our U.S. consolidated income tax group will be realized. Accordingly, in the fourth quarter of 2012 we recognized a non-recurring tax benefit of \$227 million relating to the valuation allowance reversal.

As of October 31, 2013 we continued to maintain a valuation allowance of \$41 million until sufficient positive evidence existed to support reversal. The valuation allowance primarily related to deferred tax assets for California R&D credits and net operating losses in the Netherlands and United Kingdom.

The valuation allowance decreased by \$2 million in the year ended October 31, 2014. In the fourth quarter of 2014 management concluded that the valuation allowance of our U.K. deferred tax assets is no longer needed primarily due to the emergence from cumulative losses in recent years, the return to sustainable U.K. operating profits and the expectation of sustainable profitability in future periods. Accordingly, we recognized a non-recurring tax benefit of \$6 million relating to the U.K. valuation allowance reversal. As of October 31, 2014 we have maintained a valuation allowance of \$39 million until sufficient positive evidence exists to support reversal. The valuation allowance is mainly related to deferred tax assets for California R&D credits and net operating losses in the Netherlands.

At October 31, 2014 we had U.S. federal net operating loss carryforwards of approximately \$12 million and tax credit carryforwards of approximately \$107 million. The federal net operating losses expire in years beginning 2023 through 2026, and the federal tax credits begin to expire in 2019, if not utilized. At October 31, 2014 we had state net operating loss carryforwards of approximately \$4 million that expire in years beginning 2015 through 2031 if not utilized. In addition, we had net state tax credit carryforwards of \$41 million that do not expire. All of the federal and state net operating loss carryforwards are subject to change of ownership limitations provided by the Internal Revenue Code and similar state provisions. At October 31, 2014 we also had foreign net operating loss carryforwards of approximately \$191 million. Of this foreign loss, \$133 million will expire in years beginning 2015 through

**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**5. INCOME TAXES (Continued)**

2023 if not utilized. The remaining \$58 million has an indefinite life. Some of the foreign losses are subject to annual loss limitation rules. These annual loss limitations in the U.S. and foreign jurisdictions may result in the expiration or reduced utilization of the net operating losses.

The authoritative guidance prohibits recognition of a deferred tax asset for excess tax benefits related to stock and stock option plans that have not yet been realized through reduction in income taxes payable. Such unrecognized deferred tax benefit totals \$69 million as of October 31, 2014 and will be accounted for as a credit to shareholders' equity, if and when realized, through a reduction in income taxes payable. We have recognized approximately \$30 million as a credit to shareholders' equity for cumulative excess tax benefits related to stock and stock option plans that have been realized as of October 31, 2014.

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

|  | Years Ended October 31, |        |         |
|--|-------------------------|--------|---------|
|  | 2014                    | 2013   | 2012    |
|  | (in millions)           |        |         |
| Profit before tax times statutory rate . . . . .     | \$ 166                  | \$ 175 | \$ 261  |
| State income taxes, net of federal benefit . . . . . | 6                       | 2      | 1       |
| Non-U.S. income taxed at different rates . . . . .   | (113)                   | (147)  | (209)   |
| Repatriation of foreign earnings . . . . .           | 62                      | 8      | 73      |
| Change in unrecognized tax benefits . . . . .        | (39)                    | 6      | —       |
| Valuation allowances . . . . .                       | (5)                     | —      | (227)   |
| Other, net . . . . .                                 | 6                       | —      | 6       |
| Provision for income taxes . . . . .                 | \$ 83                   | \$ 44  | \$ (95) |
| Effective tax rate . . . . .                         | 18%                     | 9%     | (13)%   |

We enjoyed tax holidays in several different jurisdictions, most significantly in Singapore through the third quarter of fiscal 2014, and several jurisdictions have granted or are anticipated to grant us tax incentives that require renewal at various times in the future, most significant being in Singapore. The tax holidays provide lower rates of taxation on certain classes of income and require various thresholds of investments and employment or specific types of income in those jurisdictions. The tax holidays are due for renewal between 2016 and 2024. As a result of the incentives, the impact of the tax holidays decreased income taxes by \$40 million, \$68 million, and \$96 million in 2014, 2013, and 2012, respectively. The benefit of the tax holidays on net income per share (diluted) was approximately \$0.24, \$0.41, and \$0.57 in 2014, 2013 and 2012, respectively.

For 2014 the effective tax rate was 18 percent. The 18 percent effective tax rate is lower than the U.S. statutory rate primarily due to the mix of earnings in non-U.S. jurisdictions taxed at lower statutory rates; in particular Singapore, where we enjoy tax holidays, combined with a \$55 million benefit from a prior year tax reserve release.

For 2013 the effective tax rate was 9 percent. The 9 percent effective tax rate is lower than the U.S. statutory rate primarily due to the mix of earnings in non-U.S. jurisdictions taxed at lower statutory rates; in particular Singapore where we enjoy tax holidays.

For 2012 the effective tax rate was 13 percent. The 13 percent effective tax rate reflected tax on earnings in jurisdictions that had low effective tax rates and includes a \$227 million tax benefit due to the

**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**5. INCOME TAXES (Continued)**

reversal of a valuation allowance for most U.S. federal and state deferred tax assets. Valuation allowances require an assessment of both positive and negative evidence when determining whether it is more likely than not that deferred tax assets are recoverable. Such assessment is required on a jurisdiction by jurisdiction basis. In the fourth quarter of 2012 management concluded that the valuation allowance for most of our U.S. federal and state deferred tax assets is no longer needed primarily due to the emergence from cumulative losses in recent years, the return to sustainable U.S. operating profits and the expectation of sustainable profitability in future periods. As of October 31, 2012 the cumulative positive evidence outweighed the negative evidence regarding the likelihood that most of the deferred tax asset for Agilent's U.S. consolidated income tax group will be realized. Accordingly, we recognized a non-recurring tax benefit of \$227 million relating to the valuation allowance reversal. The effective tax rate also included a non-recurring tax expense of \$80 million relating to an increase in the overall residual U.S. tax expected to be imposed upon the repatriation of unremitted foreign earnings previously considered permanently reinvested. During the fourth quarter of 2012, we assessed the forecasted cash needs and the overall financial position of its foreign subsidiaries and determined that a portion of previously permanently reinvested earnings would no longer be reinvested overseas.

The breakdown between current and long-term income tax assets and liabilities, excluding deferred tax assets and liabilities, was as follows for the years 2014 and 2013:

|   | October 31,   |          |
|---|---------------|----------|
|   | 2014          | 2013     |
|   | (in millions) |          |
| Current income tax liabilities (included within income and other taxes payable) ..... | \$ (60)       | \$ (20)  |
| Long-term income tax liabilities (included within other long-term liabilities) .....  | (82)          | (92)     |
| Total .....   | \$ (142)      | \$ (112) |

The calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax law and regulations in a multitude of jurisdictions. Although the guidance on the accounting for uncertainty in income taxes prescribes the use of a recognition and measurement model, the determination of whether an uncertain tax position has met those thresholds will continue to require significant judgment by management. In accordance with the guidance on the accounting for uncertainty in income taxes, for all U.S. and other tax jurisdictions, we recognize potential liabilities for anticipated tax audit issues based on our estimate of whether, and the extent to which, additional taxes and interest will be due. The ultimate resolution of tax uncertainties may differ from what is currently estimated, which could result in a material impact on income tax expense. If our estimate of income tax liabilities proves to be less than the ultimate assessment, a further charge to expense would be required. If events occur and the payment of these amounts ultimately proves to be unnecessary, the reversal of the liabilities would result in tax benefits being recognized in the period when we determine the liabilities are no longer necessary.

**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**5. INCOME TAXES (Continued)**

The aggregate changes in the balances of our unrecognized tax benefits including all federal, state and foreign tax jurisdictions are as follows:

|   | 2014          | 2013   | 2012   |
|---|---------------|--------|--------|
|   | (in millions) |        |        |
| Balance, beginning of year . . . . .                              | \$ 173        | \$ 162 | \$ 193 |
| Additions for tax positions related to the current year . . . . . | 10            | 9      | 9      |
| Additions for tax positions from prior years . . .                | 9             | 5      | 22     |
| Reductions for tax positions from prior years . .                 | (59)          | (2)    | (27)   |
| Settlements with taxing authorities . . . . .                     | (1)           | —      | (25)   |
| Statute of limitations expirations . . . . .                      | (3)           | (1)    | (10)   |
| Balance, end of year . . . . .                                    | \$ 129        | \$ 173 | \$ 162 |

As of October 31, 2014 we had \$129 million of unrecognized tax benefits of which \$118 million, if recognized, would affect our effective tax rate.

We recognized a tax benefit of \$4 million, a tax expense of \$2 million and a tax expense of \$0.3 million of interest and penalties related to unrecognized tax benefits in 2014, 2013 and 2012, respectively. Interest and penalties accrued as of October 31, 2014 and 2013 were \$8 million and \$12 million, respectively.

In the U.S., Agilent's tax years remain open back to the year 2008 for federal income tax purposes and the year 2000 for significant states. On January 29, 2014 Agilent reached an agreement with the IRS for the tax years 2006 through 2007 which resulted in \$55 million of tax benefits associated with the recognition of previously unrecognized U.S. federal and state tax benefits and the reversal of the related interest accruals resulting from this agreement and are reflected in the first quarter of 2014. Agilent's U.S. federal income tax returns for 2008 through 2011 are currently under audit by the IRS. In other major jurisdictions where we conduct 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, we are unable to estimate the range of possible changes to the balance of our unrecognized tax benefits.

**6. 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.

|  | Years Ended October 31, |         |         |
|--|-------------------------|---------|---------|
|  | 2014                    | 2013    | 2012    |
|  | (in millions)           |         |         |
| Numerator:                                 |                         |         |         |
| Net income . . . . .                       | \$ 392                  | \$ 457  | \$ 841  |
| Denominator:                               |                         |         |         |
| Basic and diluted weighted average shares  | 167                     | 167     | 167     |
| Basic and diluted net income per share . . | \$ 2.35                 | \$ 2.74 | \$ 5.04 |

**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**6. NET INCOME PER SHARE (Continued)**

Basic net income per share is computed by dividing net income (the numerator) by the weighted average number of common shares outstanding (the denominator). The denominator for basic and diluted earnings per share for the period is based on the number of shares of Keysight common stock outstanding on the distribution date. On November 1, 2014, the distribution date, Agilent shareholders of record as of the close of business on October 22, 2014 received one share of Keysight common stock for every two shares of Agilent's common stock held as of the record date. Basic and diluted net income per share and the average number of shares outstanding were calculated using the number of Keysight common shares outstanding immediately following the distribution. The same number of shares was used to calculate basic and diluted earnings per share since no Keysight equity awards were outstanding prior to the distribution.

**7. SUPPLEMENTAL CASH FLOW INFORMATION**

Net cash paid for income taxes was \$4 million in 2014 and zero in 2013 and 2012.

**8. INVENTORY**

|   | October 31,   |               |
|---|---------------|---------------|
|   | 2014          | 2013          |
|   | (in millions) |               |
| Finished goods . . . . .                            | \$ 219        | \$ 209        |
| Purchased parts and fabricated assemblies . . . . . | 279           | 293           |
| Inventory . . . . .                                 | <u>\$ 498</u> | <u>\$ 502</u> |

Inventory-related excess and obsolescence charges of \$33 million were recorded in total cost of products in 2014, \$21 million in 2013 and \$14 million in 2012. 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-cancellable purchase commitments.

**9. PROPERTY, PLANT AND EQUIPMENT, NET**

|   | October 31,    |               |
|---|----------------|---------------|
|   | 2014           | 2013          |
|   | (in millions)  |               |
| Land . . . . .                                      | \$ 61          | \$ 68         |
| Buildings and leasehold improvements . . . . .      | 627            | 647           |
| Machinery and equipment . . . . .                   | 861            | 512           |
| Software . . . . .                                  | 6              | 8             |
| Total property, plant and equipment . . . . .       | 1,555          | 1,235         |
| Accumulated depreciation and amortization . . . . . | <u>(1,085)</u> | <u>(766)</u>  |
| Property, plant and equipment, net . . . . .        | <u>\$ 470</u>  | <u>\$ 469</u> |

Asset impairments were zero in 2014, 2013 and 2012. Depreciation expense was \$74 million in 2014, \$65 million in 2013 and \$55 million in 2012.

**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**10. GOODWILL AND OTHER INTANGIBLE ASSETS**

The goodwill balances at October 31, 2014, 2013 and 2012 and the movements in 2014 and 2013 for each of our reportable segments are shown in the table below:

|   | Customer<br>Support and<br>Services | Measurement<br>Solutions | Total         |
|---|-------------------------------------|--------------------------|---------------|
|   | (in millions)                       |                          |               |
| <b>Goodwill as of October 31, 2012</b> . . . . .                      | \$ 60                               | \$ 407                   | \$ 467        |
| Foreign currency translation impact . . . . .                         | (6)                                 | (41)                     | (47)          |
| Goodwill arising from acquisitions and other<br>adjustments . . . . . | —                                   | (1)                      | (1)           |
| <b>Goodwill as of October 31, 2013</b> . . . . .                      | \$ 54                               | \$ 365                   | \$ 419        |
| Foreign currency translation impact . . . . .                         | (4)                                 | (28)                     | (32)          |
| Goodwill arising from acquisitions and other<br>adjustments . . . . . | 5                                   | —                        | 5             |
| <b>Goodwill as of October 31, 2014</b> . . . . .                      | <u>\$ 55</u>                        | <u>\$ 337</u>            | <u>\$ 392</u> |

The component parts of other intangible assets at October 31, 2014 and 2013 are shown in the table below:

|   | Other Intangible Assets     |   |                   |
|---|-----------------------------|---|-------------------|
|   | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization<br>and<br>Impairments | Net Book<br>Value |
|   | (in millions)               |   |                   |
| <b>As of October 31, 2013:</b>                |                             |   |                   |
| Developed technology . . . . .                | \$ 123                      | \$ 108  | \$ 15             |
| Backlog . . . . .                             | 4                           | 4   | —                 |
| Trademark/Tradename . . . . .                 | 1                           | 1   | —                 |
| Customer relationships . . . . .              | 26                          | 23  | 3                 |
| Total amortizable intangible assets . . . . . | \$ 154                      | \$ 136  | \$ 18             |
| In-Process R&D . . . . .                      | 2                           | —   | 2                 |
| Total . . . . .                               | <u>\$ 156</u>               | <u>\$ 136</u>                                     | <u>\$ 20</u>      |
| <b>As of October 31, 2014:</b>                |                             |   |                   |
| Developed technology . . . . .                | \$ 125                      | \$ 114  | \$ 11             |
| Backlog . . . . .                             | 4                           | 4   | —                 |
| Trademark/Tradename . . . . .                 | 1                           | 1   | —                 |
| Customer relationships . . . . .              | 32                          | 25  | 7                 |
| Total amortizable intangible assets . . . . . | \$ 162                      | \$ 144  | \$ 18             |
| In-Process R&D . . . . .                      | —                           | —   | —                 |
| Total . . . . .                               | <u>\$ 162</u>               | <u>\$ 144</u>                                     | <u>\$ 18</u>      |

**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**10. GOODWILL AND OTHER INTANGIBLE ASSETS (Continued)**

In 2014 we recorded additions to goodwill of \$5 million related to the acquisition of a business. During the year, we also recorded \$6 million of additions to other intangibles related to the same business. The \$2 million decrease in in-process R&D was due to the completion of one project.

In 2013 goodwill decreased by \$1 million relating to an adjustment of a prior year acquisition's goodwill. In 2013 we also recorded \$2 million of other intangibles in total, with \$1 million related to the same adjustment of a prior year's acquisition and the remainder relating to another acquisition.

Amortization of intangible assets was \$8 million in 2014, \$9 million in 2013, and \$7 million in 2012. In addition, we recorded \$1 million of impairments of other intangibles related to the cancellation of an in-process research and development project during 2013. Future amortization expense related to existing finite-lived purchased intangible assets is estimated to be \$8 million in 2015, \$6 million for 2016, \$3 million for 2017, \$1 million for 2018, and zero thereafter.

**11. INVESTMENTS**

*Equity Investments*

The following table summarizes the company's equity investments as of October 31, 2014 and 2013 (net book value):

|  | October 31,   |       |
|--|---------------|-------|
|  | 2014          | 2013  |
|  | (in millions) |       |
| <b>Long-Term</b>                         |               |       |
| Cost method investments . . . . .        | \$ 15         | \$ 10 |
| Trading securities . . . . .             | 13            | 11    |
| Available-for-sale investments . . . . . | 35            | 23    |
| Total . . . . .                          | \$ 63         | \$ 44 |

Cost method investments consist of non-marketable equity securities and two funds and are accounted for at historical cost. Trading securities are reported at fair value, with gains or losses resulting from changes in fair value recognized currently in earnings. Investments designated as available-for-sale are reported at fair value, with unrealized gains and losses, net of tax, included in stockholders' equity.

Investments in available-for-sale securities at estimated fair value were as follows:

|                             | October 31, 2014 |                              |                               | October 31, 2013        |       |                              |                               |                         |
|-----------------------------|------------------|------------------------------|-------------------------------|-------------------------|-------|------------------------------|-------------------------------|-------------------------|
|                             | Cost             | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair Value | Cost  | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair Value |
|                             | (in millions)    |                              |                               |                         |       |                              |                               |                         |
| Equity securities . . . . . | \$ 15            | \$ 20                        | \$ —                          | \$ 35                   | \$ 15 | \$ 8                         | \$ —                          | \$ 23                   |

All of our investments, excluding trading securities, are subject to periodic impairment review. The impairment analysis requires significant judgment to identify events or circumstances that would likely have a significant adverse effect on the future value of the investment. We consider various factors in determining whether an impairment is other-than-temporary, including the severity and duration of the impairment, forecasted recovery, the financial condition and near-term prospects of the investee, and our

## KEYSIGHT TECHNOLOGIES, INC.

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### 11. INVESTMENTS (Continued)

ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value.

There were no realized gains on the sale of available-for-sale securities in 2014, 2013 and 2012.

Net unrealized gains and losses on our trading securities portfolio were \$1 million of unrealized gains in 2014, \$2 million of unrealized gains in 2013 and \$1 million of unrealized gains in 2012.

Realized gains from the sale of cost method securities were zero for 2014, 2013 and 2012.

#### 12. FAIR VALUE MEASUREMENTS

The authoritative guidance defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, we consider the principal or most advantageous market and assumptions that market participants would use when pricing the asset or liability.

##### *Fair Value Hierarchy*

The guidance establishes a fair value hierarchy that prioritizes the use of inputs used in valuation techniques into three levels. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. There are three levels of inputs that may be used to measure fair value:

*Level 1*—applies to assets or liabilities for which there are quoted prices in active markets for identical assets or liabilities.

*Level 2*—applies to assets or liabilities for which there are inputs other than quoted prices included within Level 1 that are observable, either directly or indirectly, for the asset or liability such as: quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in less active markets; or other inputs that can be derived principally from, or corroborated by, observable market data.

*Level 3*—applies to assets or liabilities for which there are unobservable inputs to the valuation methodology that are significant to the measurement of the fair value of the assets or liabilities.



KEYSIGHT TECHNOLOGIES, INC.

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

12. FAIR VALUE MEASUREMENTS (Continued)

*Financial Assets and Liabilities Measured at Fair Value on a Recurring Basis*

Financial assets and liabilities measured at fair value on a recurring basis as of October 31, 2014 were as follows:

|  | October 31,<br>2014 | Fair Value Measurement at<br>October 31, 2014 Using                              |   |  |
|--|---------------------|--|---|--|
|  |                     | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| (in millions)  |                     |  |   |  |
| Assets:  |                     |  |   |  |
| Short-term   |                     |  |   |  |
| Cash equivalents (money market funds) . . . . .                  | \$ 634              | \$ 634   | \$ —  | \$ —   |
| Derivative instruments (foreign exchange<br>contracts) . . . . . | 9                   | —  | 9   | —  |
| Long-term  |                     |  |   |  |
| Trading securities . . . . .                                     | 13                  | 13   | —   | —  |
| Available-for-sale investments . . . . .                         | 35                  | 35   | —   | —  |
| Total assets measured at fair value . . . . .                    | <u>\$ 691</u>       | <u>\$ 682</u>  | <u>\$ 9</u>   | <u>\$ —</u>  |
| Liabilities:   |                     |  |   |  |
| Short-term   |                     |  |   |  |
| Derivative instruments (foreign exchange<br>contracts) . . . . . | \$ 3                | \$ —   | \$ 3  | \$ —   |
| Long-term  |                     |  |   |  |
| Deferred compensation liability . . . . .                        | 13                  | —  | 13  | —  |
| Total liabilities measured at fair value . . . . .               | <u>\$ 16</u>        | <u>\$ —</u>  | <u>\$ 16</u>  | <u>\$ —</u>  |

**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**12. FAIR VALUE MEASUREMENTS (Continued)**

Financial assets and liabilities measured at fair value on a recurring basis as of October 31, 2013 were as follows:

|  | October 31,<br>2013 | Fair Value Measurement at<br>October 31, 2013 Using                              |   |  |
|--|---------------------|--|---|--|
|  |                     | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| (in millions)                                      |                     |  |   |  |
| <b>Assets:</b>                                     |                     |  |   |  |
| Long-term  |                     |  |   |  |
| Trading securities . . . . .                       | \$ 11               | \$ 11  | \$ —  | \$ —   |
| Available-for-sale investments . . . . .           | 23                  | 23   | —   | —  |
| Total assets measured at fair value . . . . .      | <u>\$ 34</u>        | <u>\$ 34</u>   | <u>\$ —</u>   | <u>\$ —</u>  |
| <b>Liabilities:</b>                                |                     |  |   |  |
| Long-term  |                     |  |   |  |
| Deferred compensation liability . . . . .          | 11                  | —  | 11  | —  |
| Total liabilities measured at fair value . . . . . | <u>\$ 11</u>        | <u>\$ —</u>  | <u>\$ 11</u>  | <u>\$ —</u>  |

Our money market funds, trading securities, and available-for-sale investments are generally valued using quoted market prices and therefore are classified within Level 1 of the fair value hierarchy. Our derivative financial instruments are classified within Level 2, as there is not an active market for each hedge contract, but the inputs used to calculate the value of the instruments are tied to active markets. Our deferred compensation liability is classified as Level 2 because although the values are not directly based on quoted market prices, the inputs used in the calculations are observable.

Trading securities and deferred compensation liability are reported at fair value, with gains or losses resulting from changes in fair value recognized currently in net income. Investments designated as available-for-sale and certain derivative instruments are reported at fair value, with unrealized gains and losses, net of tax, included in stockholders' equity. Realized gains and losses from the sale of these instruments are recorded in net income.

*Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis*

*Long-Lived Assets*

For assets measured at fair value on a non-recurring basis, the following table summarizes the impairments included in net income for the years ended October 31, 2014 and 2013:

|   | Years Ended<br>October 31, |      |
|---|----------------------------|------|
|   | 2014                       | 2013 |
| (in millions)                             |                            |      |
| Long-lived assets held and used . . . . . | \$ —                       | \$ 1 |

## KEYSIGHT TECHNOLOGIES, INC.

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### 12. FAIR VALUE MEASUREMENTS (Continued)

Long-lived assets held and used related to the cancellation of an in-process research and development project with a carrying amount of \$1 million were written down to their fair value of zero, resulting in an impairment charge of \$1 million, which was included in net income for 2013. Fair values for the impaired long-lived assets were measured using level 2 inputs.

#### 13. DERIVATIVES

We are exposed to foreign currency exchange rate fluctuations and interest rate changes in the normal course of our business. As part of risk management strategy, we use derivative instruments, primarily forward contracts and purchased options to hedge economic and/or accounting exposures resulting from changes in foreign currency exchange rates. Prior to the Capitalization, there were no derivatives contracts legally held by us and the below disclosures represent the activity pertaining to the contracts entered into by us subsequently.

##### *Cash Flow Hedges*

We enter into foreign exchange contracts to hedge our forecasted operational cash flow exposures resulting from changes in foreign currency exchange rates. These foreign exchange contracts, carried at fair value, have maturities between one and twelve months. These derivative instruments are designated and qualify as cash flow hedges under the criteria prescribed in the authoritative guidance. The changes in the value of the effective portion of the derivative instrument are recognized in accumulated other comprehensive income. Amounts associated with cash flow hedges are reclassified to cost of sales in the combined and consolidated statement of operations when the forecasted transaction occurs. If it becomes probable that the forecasted transaction will not occur, the hedge relationship will be de-designated and amounts accumulated in other comprehensive income will be reclassified to other income (expense), net in the current period. Changes in the fair value of the ineffective portion of derivative instruments are recognized in earnings in the combined and consolidated statement of operations in the current period. We record the premium paid (time value) of an option on the date of purchase as an asset. For options designated as cash flow hedges, changes in the time value are excluded from the assessment of hedge effectiveness and are recognized in other income (expense) over the life of the option contract. Ineffectiveness in 2014, 2013 and 2012 was not significant.

##### *Other Hedges*

Additionally, we enter into foreign exchange contracts to hedge monetary assets and liabilities that are denominated in currencies other than the functional currency of our subsidiaries. These foreign exchange contracts are carried at fair value and do not qualify for hedge accounting treatment and are not designated as hedging instruments. Changes in value of the derivative are recognized in other income (expense), net in the combined and consolidated statement of operations, in the current period, along with the offsetting foreign currency gain or loss on the underlying assets or liabilities.

Our use of derivative instruments exposes us to credit risk to the extent that the counterparties may be unable to meet the terms of the agreement. We do, however, seek to mitigate such risks by limiting our counterparties to major financial institutions which are selected based on their credit ratings and other factors. We have established policies and procedures for mitigating credit risk that include establishing counterparty credit limits, monitoring credit exposures, and continually assessing the creditworthiness of counterparties.

**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**13. DERIVATIVES (Continued)**

A number of our derivative agreements contain threshold limits to the net liability position with counterparties and are dependent on our corporate credit rating determined by the major credit rating agencies. The counterparties to the derivative instruments may request collateralization, in accordance with derivative agreements, on derivative instruments in net liability positions.

The aggregate fair value of all derivative instruments with credit-risk-related contingent features that were in a net liability position as of October 31, 2014 was \$1 million. The credit-risk-related contingent features underlying these agreements had not been triggered as of October 31, 2014.

There were 67 foreign exchange forward contracts and 2 foreign exchange option contracts open as of October 31, 2014 and designated as cash flow hedges. There were 80 foreign exchange forward contracts open as of October 31, 2014 not designated as hedging instruments. The aggregated U.S. Dollar notional amounts by currency and designation as of October 31, 2014 were as follows:

| <u>Currency</u>             | <b>Derivatives in Cash Flow Hedging Relationships</b> |                         | <b>Derivatives Not Designated as Hedging Instruments</b> |
|-----------------------------|---|-------------------------|--|
|                             | <b>Forward Contracts</b>                              | <b>Option Contracts</b> | <b>Forward Contracts</b>                                 |
|                             | <b>Buy/(Sell)</b>                                     | <b>Buy/(Sell)</b>       | <b>Buy/(Sell)</b>  |
|                             | (in millions)   |                         |  |
| Euro . . . . .              | \$ —  | \$ —                    | \$ 22  |
| British Pound . . . . .     | —   | —                       | 39   |
| Malaysian Ringgit . . . . . | 91  | —                       | 19   |
| Japanese Yen . . . . .      | (86)  | (23)                    | (34)   |
| Other . . . . .             | (15)  | —                       | 8  |
|                             | \$ (10)   | \$ (23)                 | \$ 54  |

KEYSIGHT TECHNOLOGIES, INC.

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

13. DERIVATIVES (Continued)

Derivative instruments are subject to master netting arrangements and are disclosed gross in the balance sheet. The gross fair values and balance sheet location of derivative instruments held in the combined and consolidated balance sheet as of October 31, 2014 and 2013 were as follows:

| Fair Values of Derivative Instruments                     |                  |                  |                           |                  |                  |
|---|------------------|------------------|---------------------------|------------------|------------------|
| Asset Derivatives   |                  |                  | Liability Derivatives     |                  |                  |
| Balance Sheet Location                                    | Fair Value       |                  | Balance Sheet Location    | Fair Value       |                  |
|   | October 31, 2014 | October 31, 2013 |                           | October 31, 2014 | October 31, 2013 |
| (in millions)   |                  |                  |                           |                  |                  |
| <b>Derivatives designated as hedging instruments:</b>     |                  |                  |                           |                  |                  |
| <i>Cash flow hedges</i>                                   |                  |                  |                           |                  |                  |
| Foreign exchange contracts                                |                  | Other            | Other accrued liabilities |                  |                  |
| current assets . . . . .                                  | \$ 7             | \$ —             |                           | \$ 1             | \$ —             |
| <b>Derivatives not designated as hedging instruments:</b> |                  |                  |                           |                  |                  |
| Foreign exchange contracts                                |                  | Other            | Other accrued liabilities |                  |                  |
| current assets . . . . .                                  | 2                | —                |                           | 2                | —                |
| Total derivatives . . . . .                               | <u>\$ 9</u>      | <u>\$ —</u>      |                           | <u>\$ 3</u>      | <u>\$ —</u>      |

The effect of derivative instruments for foreign exchange contracts designated as hedging instruments and not designated as hedging instruments in our combined and consolidated statement of operations was as follows:

|   | 2014          | 2013 | 2012 |
|---|---------------|------|------|
|   | (in millions) |      |      |
| <b>Derivatives designated as hedging instruments:</b>               |               |      |      |
| <i>Cash flow hedges</i>   |               |      |      |
| Gain recognized in accumulated other comprehensive income . . . . . | \$ 5          | \$ — | \$ — |
| <b>Derivatives not designated as hedging instruments:</b>           |               |      |      |
| Gain (loss) recognized in other income (expense), net . . . . .     | \$ 3          | \$ — | \$ — |

The estimated net amount of existing gain at October 31, 2014 that is expected to be reclassified from other comprehensive income to cost of sales within the next twelve months is \$5 million.

**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**14. RESTRUCTURING**

In the second quarter of 2013, in response to slow revenue growth due to macroeconomic conditions, we accrued for a targeted restructuring program that was expected to reduce Keysight's total headcount by approximately 200 regular employees, representing approximately 2 percent of our global workforce. After the separation announcement in the fourth quarter of 2013, approximately 40 employees from the targeted restructuring plan have been redeployed within the company, reducing the total headcount under this plan to 160 employees.

A summary of total restructuring accrual activity is shown in the table below:

|   | <b>Workforce<br/>Reduction</b> |
|---|--------------------------------|
|   | (in millions)                  |
| <b>Balance as of October 31, 2013</b> ..... | \$ 6                           |
| Income statement expense (reversal) .....   | (3)                            |
| Cash payments .....                         | (2)                            |
| <b>Balance as of October 31, 2014</b> ..... | \$ 1                           |

The restructuring reversal of \$3 million recorded in 2014 related to approximately 40 employees that have been redeployed within the company as a result of the separation announcement. At October 31, 2014, we have a remaining accrual of \$1 million recorded in other accrued liabilities in the combined and consolidated balance sheet, and we have substantially completed this program.

A summary of the charges in the combined and consolidated statement of operations resulting from all restructuring plans is shown below:

|  | Year Ended October 31, |       |
|--|------------------------|-------|
|  | 2014                   | 2013  |
|  | (in millions)          |       |
| Cost of products and services .....                                    | \$ (1)                 | \$ 4  |
| Research and development .....   | (1)                    | 5     |
| Selling, general and administrative .....                              | (1)                    | 6     |
| Total restructuring, asset impairments and other special charges ..... | \$ (3)                 | \$ 15 |

**15. RETIREMENT PLANS AND POST-RETIREMENT PENSION PLANS**

*General.* Prior to the Capitalization, substantially all of our employees were covered under various defined benefit and/or defined contribution retirement plans sponsored by Agilent. All defined benefit retirement plans and the post-retirement health care plan were considered multi-employer plans. As a result, no asset or liability was recorded by us to recognize the funded status in our combined and consolidated balance sheet until the Capitalization. At the Capitalization, the assets and liabilities of these plans that were allocable to Keysight employees were transferred to Keysight plans; therefore, the plans are no longer considered multi-employer plans. Plan assets of \$2,037 million, benefit obligations of \$2,157 million and \$344 million of accumulated other comprehensive loss (\$270 million, net of tax) were recorded for the plans transferred to us.

## KEYSIGHT TECHNOLOGIES, INC.

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### 15. RETIREMENT PLANS AND POST-RETIREMENT PENSION PLANS (Continued)

Substantially all of our employees are covered under various defined benefit and/or defined contribution retirement plans. Additionally, we sponsor post-retirement health care benefits for our eligible U.S. employees. We provide U.S. employees, who meet eligibility criteria under the Keysight Technologies, Inc. Retirement Plan (“RP”), defined benefits which are based on an employee’s base or target pay during the years of employment and on length of service. For eligible service through October 31, 1993, the benefit payable under the RP is reduced by any amounts due to the eligible employee under our defined contribution Deferred Profit-Sharing Plan (“DPSP”), which was closed to new participants as of November 1993.

In addition, in the U.S. we maintain the Supplemental Benefits Retirement Plan (“SBRP”), a supplemental unfunded non-qualified defined benefit plan to provide benefits that would be provided under the RP but for limitations imposed by the Internal Revenue Code. The RP and the SBRP comprise the “U.S. Plans.”

As of October 31, 2014 the fair value of plan assets of the DPSP for U.S. employees was \$331 million. Note that the projected benefit obligation for the DPSP equals the fair value of plan assets.

Eligible employees outside the U.S. generally receive retirement benefits under various retirement plans (“Non-U.S. Plans”) based upon factors such as years of service and/or employee compensation levels. Eligibility is generally determined in accordance with local statutory requirements.

*401(k) defined contribution plan.* Eligible U.S. employees may participate in the Keysight Technologies, Inc. 401(k) Plan (the “401(k) Plan”). 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 50 percent of an employee’s annual eligible compensation, subject to regulatory limitations. The 401(k) Plan employer expense included in income from operations was \$12 million in 2014, including allocated costs and contributions made from Agilent of \$9 million. Agilent allocated costs and made contributions to the 401(k) Plan on our behalf in the amount of \$12 million for each of the two years ended October 31, 2013.

*Post-retirement medical benefit plans.* In addition to receiving retirement benefits, U.S. employees who meet eligibility requirements as of their termination date may participate in the Keysight Technologies, Inc. Health Plan for Retirees (“U.S. Post-Retirement Benefit Plans”). Eligible retirees who were less than age 50 as of January 1, 2005 and who retire after age 55 with 15 or more years of service (age 54 with 14 or more years of service for workforce managed terminations) are eligible for a fixed amount which can be utilized to pay for premiums under a Keysight sponsored pre-Medicare medical plan, non-Keysight sponsored medical, dental and vision plans purchased in the individual insurance market, as well as Medicare Part A, Medicare Part B and prescription drug premiums. Premiums to purchase other employer-sponsored coverage are not eligible for reimbursement. Eligible retirees who were at least age 50 as of January 1, 2005 and who retire after age 55 with 15 or more years of service (age 54 with 14 or more years of service for workforce managed terminations) currently choose from managed-care or indemnity options, with the company subsidization level or stipend dependent on a number of factors including eligibility and length of service. Grandfathered retirees receive a fixed monthly subsidy toward pre-65 premium costs (subsidy capped at 2011 levels) and a fixed monthly stipend post-65. The subsidy amounts will not increase.

**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**15. RETIREMENT PLANS AND POST-RETIREMENT PENSION PLANS (Continued)**

*Components of net periodic cost.* The company uses alternate methods of amortization, as allowed by the authoritative guidance, which amortizes the actuarial gains and losses on a consistent basis for the years presented. For the U.S. Plans, gains and losses are amortized over the average future working lifetime. For most Non-U.S. Plans and the U.S. Post-Retirement Benefit Plan, gains and losses are amortized using a separate layer for each year's gains and losses.

For the years ended October 31, 2014, 2013 and 2012, components of net periodic benefit cost (benefit) and other amounts recognized in other comprehensive income were comprised of:

|   | Defined Benefit Plans |             |             |                |              |              | U.S. Post-Retirement<br>Benefit Plan |                |                |
|---|-----------------------|-------------|-------------|----------------|--------------|--------------|--------------------------------------|----------------|----------------|
|   | U.S. Plans            |             |             | Non-U.S. Plans |              |              | 2014                                 | 2013           | 2012           |
|   | 2014                  | 2013        | 2012        | 2014           | 2013         | 2012         |                                      |                |                |
|   | (in millions)         |             |             |                |              |              |                                      |                |                |
| <b>Net periodic benefit cost (benefit)</b>  |                       |             |             |                |              |              |                                      |                |                |
| Service cost—benefits earned during the period . . . . .  | \$ 5                  | \$ —        | \$ —        | \$ 4           | \$ —         | \$ —         | \$ —                                 | \$ —           | \$ —           |
| Interest cost on benefit obligation . . . . .   | 5                     | —           | —           | 11             | —            | —            | 2                                    | —              | —              |
| Expected return on plan assets . . . . .  | (10)                  | —           | —           | (19)           | —            | —            | (4)                                  | —              | —              |
| Amortization of net actuarial loss . . . . .  | 1                     | —           | —           | 7              | —            | —            | 2                                    | —              | —              |
| Amortization of prior service credit . . . . .  | (1)                   | —           | —           | —              | —            | —            | (5)                                  | —              | —              |
| Net periodic benefit cost (benefit) . . . . .   | —                     | —           | —           | 3              | —            | —            | (5)                                  | —              | —              |
| Allocated benefit cost (benefit) from Agilent . . . . .   | 3                     | 9           | 8           | 9              | 23           | 26           | (9)                                  | (10)           | (10)           |
| <b>Total periodic benefit cost (benefit) . . . . .</b>  | <b>\$ 3</b>           | <b>\$ 9</b> | <b>\$ 8</b> | <b>\$ 12</b>   | <b>\$ 23</b> | <b>\$ 26</b> | <b>\$ (14)</b>                       | <b>\$ (10)</b> | <b>\$ (10)</b> |
| <b>Other changes in plan assets and benefit obligations recognized in other comprehensive (income) loss</b> |                       |             |             |                |              |              |                                      |                |                |
| Prior service credits assumed at Capitalization . . . . .   | \$ (33)               | \$ —        | \$ —        | \$ (3)         | \$ —         | \$ —         | \$ (102)                             | \$ —           | \$ —           |
| Net actuarial loss assumed at Capitalization . . . . .  | 40                    | —           | —           | 367            | —            | —            | 75                                   | —              | —              |
| Net actuarial loss . . . . .  | 5                     | —           | —           | 39             | —            | —            | 7                                    | —              | —              |
| Amortization of net actuarial loss . . . . .  | (1)                   | —           | —           | (7)            | —            | —            | (2)                                  | —              | —              |
| Amortization of prior service credit . . . . .  | 1                     | —           | —           | —              | —            | —            | 5                                    | —              | —              |
| Foreign currency . . . . .  | —                     | —           | —           | 9              | —            | —            | —                                    | —              | —              |
| Total recognized in other comprehensive (income) loss . . . . .   | \$ 12                 | \$ —        | \$ —        | \$ 405         | \$ —         | \$ —         | \$ (17)                              | \$ —           | \$ —           |
| Total recognized in net periodic benefit cost (benefit) and other comprehensive (income) loss . . . . .     | <u>\$ 15</u>          | <u>\$ 9</u> | <u>\$ 8</u> | <u>\$ 417</u>  | <u>\$ 23</u> | <u>\$ 26</u> | <u>\$ (31)</u>                       | <u>\$ (10)</u> | <u>\$ (10)</u> |



KEYSIGHT TECHNOLOGIES, INC.

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

15. RETIREMENT PLANS AND POST-RETIREMENT PENSION PLANS (Continued)

*Funded status.* As of October 31, 2014 and 2013, the funded status of the defined benefit and post-retirement benefit plans was as follows:

|   | U.S. Defined Benefit Plans |      | Non-U.S. Defined Benefit Plans |      | U.S. Post-Retirement Benefit Plan |      |
|---|----------------------------|------|--------------------------------|------|-----------------------------------|------|
|   | 2014                       | 2013 | 2014                           | 2013 | 2014                              | 2013 |
|   | (in millions)              |      |                                |      |                                   |      |
| Change in fair value of plan assets:  |                            |      |                                |      |                                   |      |
| Fair value—beginning of year  | \$ —                       | \$ — | \$ —                           | \$ — | \$ —                              | \$ — |
| Assets received at Capitalization   | 490                        | —    | 1,358                          | —    | 189                               | —    |
| Actual return on plan assets  | 7                          | —    | 46                             | —    | 2                                 | —    |
| Employer contributions  | —                          | —    | 10                             | —    | —                                 | —    |
| Benefits paid   | (6)                        | —    | (9)                            | —    | (4)                               | —    |
| Currency impact   | —                          | —    | (87)                           | —    | —                                 | —    |
| Fair value—end of year  | \$ 491                     | \$ — | \$ 1,318                       | \$ — | \$ 187                            | \$ — |
| Change in benefit obligation:   |                            |      |                                |      |                                   |      |
| Benefit obligation—beginning of year  | \$ —                       | \$ — | \$ —                           | \$ — | \$ —                              | \$ — |
| Liabilities assumed at Capitalization   | 508                        | —    | 1,446                          | —    | 203                               | —    |
| Service cost  | 5                          | —    | 4                              | —    | —                                 | —    |
| Interest cost   | 5                          | —    | 11                             | —    | 2                                 | —    |
| Plan amendment  | —                          | —    | (1)                            | —    | —                                 | —    |
| Actuarial loss  | 2                          | —    | 70                             | —    | 5                                 | —    |
| Benefits paid   | (6)                        | —    | (9)                            | —    | (4)                               | —    |
| Currency impact   | —                          | —    | (92)                           | —    | —                                 | —    |
| Benefit obligation—end of year  | \$ 514                     | \$ — | \$ 1,429                       | \$ — | \$ 206                            | \$ — |
| Underfunded status of PBO   | \$ (23)                    | \$ — | \$ (111)                       | \$ — | \$ (19)                           | \$ — |
| Amounts recognized in the combined and consolidated balance sheet consist of: |                            |      |                                |      |                                   |      |
| Other assets  | \$ —                       | \$ — | \$ 48                          | \$ — | \$ —                              | \$ — |
| Employee compensation and benefits  | (1)                        | —    | —                              | —    | —                                 | —    |
| Retirement and post-retirement benefits                                       | (22)                       | —    | (159)                          | —    | (19)                              | —    |
| Net liability   | \$ (23)                    | \$ — | \$ (111)                       | \$ — | \$ (19)                           | \$ — |
| Amounts recognized in accumulated other comprehensive income (loss):          |                            |      |                                |      |                                   |      |
| Actuarial losses  | \$ 44                      | \$ — | \$ 408                         | \$ — | \$ 80                             | \$ — |
| Prior service credits   | (32)                       | —    | (3)                            | —    | (97)                              | —    |
| Total   | \$ 12                      | \$ — | \$ 405                         | \$ — | \$ (17)                           | \$ — |

The amounts in accumulated other comprehensive income expected to be amortized into net periodic benefit cost (benefit) during 2015 are as follows:

|  | U.S. Defined Benefit Plans |     | Non-U.S. Defined Benefit Plans |     | U.S. Post-Retirement Benefit Plan |      |
|--|----------------------------|-----|--------------------------------|-----|-----------------------------------|------|
|  |                            |     |                                |     |                                   |      |
|  | (in millions)              |     |                                |     |                                   |      |
| Amortization of net prior service credit | \$                         | (7) | \$                             | (1) | \$                                | (21) |
| Amortization of actuarial net loss       | \$                         | 4   | \$                             | 29  | \$                                | 12   |

## KEYSIGHT TECHNOLOGIES, INC.

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### 15. RETIREMENT PLANS AND POST-RETIREMENT PENSION PLANS (Continued)

*Investment policies and strategies as of October 31, 2014.* In the U.S., our RP and U.S. Post-Retirement Benefit Plan target asset allocations are approximately 80 percent to equities and approximately 20 percent to fixed income investments. Our DPSP target asset allocation is approximately 60 percent to equities and approximately 40 percent to fixed income investments. The general investment objective for all our plan assets is to obtain the optimum rate of investment return on the total investment portfolio consistent with the assumption of a reasonable level of risk. Specific investment objectives for the plans' portfolios are to: maintain and enhance the purchasing power of the plans' assets; achieve investment returns consistent with the level of risk being taken; and earn performance rates of return in accordance with the benchmarks adopted for each asset class. Outside the U.S., our target asset allocation is from 37 to 60 percent to equities, from 40 to 60 percent to fixed income investments, and from zero to 6 percent to real estate investments and from zero to 7 percent to cash, depending on the plan. All plans' assets are broadly diversified. Due to fluctuations in capital markets, our actual allocations of plan assets at October 31, 2014 differ from the target allocation. Our policy is to periodically bring the actual allocation in line with the target allocation.

Equity securities include exchange-traded common stock and preferred stock of companies from broadly diversified industries. Fixed income securities include a portfolio of corporate bonds of companies from diversified industries, government securities, mortgage-backed securities, asset-backed securities, derivative instruments and other. Portions of the cash and cash equivalent, equity, and fixed income investments are held in commingled funds.

*Fair Value.* The measurement of the fair value of pension and post-retirement plan assets uses the valuation methodologies and the inputs as described in Note 12, "Fair Value Measurements."

Cash and Cash Equivalents—Cash and cash equivalents consist of short-term investment funds. The funds also invest in short-term domestic fixed income securities and other securities with debt-like characteristics emphasizing short-term maturities and quality. Cash and cash equivalents are classified as Level 1 investments except when the cash and cash equivalents are held in commingled funds, which have a daily net value derived from quoted prices for the underlying securities in active markets; these are classified as Level 2 investments.

Equity—Some equity securities consisting of common and preferred stock are held in commingled funds, which have daily net asset values derived from quoted prices for the underlying securities in active markets; these are classified as Level 2 investments. Commingled funds which have quoted prices in active markets are classified as Level 1 investments.

Fixed Income—Some of the fixed income securities are held in commingled funds, which have daily net asset values derived from the underlying securities; these are classified as Level 2 investments. Commingled funds which have quoted prices in active markets are classified as Level 1 investments.

Other Investments—Other investments include property-based pooled vehicles which invest in real estate. Market net asset values are regularly published in the financial press or on corporate websites and so these investments are classified as Level 2 and 3.

KEYSIGHT TECHNOLOGIES, INC.

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

15. RETIREMENT PLANS AND POST-RETIREMENT PENSION PLANS (Continued)

The following table presents the fair value of U.S. Defined Benefit Plans assets classified under the appropriate level of the fair value hierarchy as of October 31, 2014:

|   | October 31,<br>2014 | Fair Value Measurement<br>at October 31, 2014 Using                        |   |  |
|---|---------------------|--|---|--|
|   |                     | Quoted Prices<br>in Active<br>Markets for<br>Identical Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|   |                     | (in millions)  |   |  |
| Cash and Cash Equivalents . . . . .           | \$ 6                | \$ 1   | \$ 5  | \$ —   |
| Equity . . . . .                              | 365                 | 86   | 279   | —  |
| Fixed Income . . . . .                        | 120                 | 40   | 80  | —  |
| Other Investments . . . . .                   | —                   | —  | —   | —  |
| Total assets measured at fair value . . . . . | <u>\$ 491</u>       | <u>\$ 127</u>  | <u>\$ 364</u>   | <u>\$ —</u>  |

For U.S. Defined Benefit Plans, there was no activity relating to assets measured at fair value using significant unobservable inputs (Level 3) during fiscal year 2014.

The following table presents the fair value of U.S. Post-Retirement Benefit Plan assets classified under the appropriate level of the fair value hierarchy as of October 31, 2014:

|   | October 31,<br>2014 | Fair Value Measurement at<br>October 31, 2014 Using                              |   |  |
|---|---------------------|--|---|--|
|   |                     | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|   |                     | (in millions)  |   |  |
| Cash and Cash Equivalents . . . . .           | \$ 3                | \$ 1   | \$ 2  | \$ —   |
| Equity . . . . .                              | 143                 | 34   | 109   | —  |
| Fixed Income . . . . .                        | 41                  | 14   | 27  | —  |
| Other Investments . . . . .                   | —                   | —  | —   | —  |
| Total assets measured at fair value . . . . . | <u>\$ 187</u>       | <u>\$ 49</u>   | <u>\$ 138</u>   | <u>\$ —</u>  |

For U.S. Post-Retirement Benefit Plan, there was no activity relating to assets measured at fair value using significant unobservable inputs (Level 3) during fiscal year 2014.

**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**15. RETIREMENT PLANS AND POST-RETIREMENT PENSION PLANS (Continued)**

The following table presents the fair value of Non-U.S. Defined Benefit Plans assets classified under the appropriate level of the fair value hierarchy as of October 31, 2014:

|   | Fair Value Measurement at<br>October 31, 2014 Using |  |   |  |
|---|---|--|---|--|
|   | October 31,<br>2014                                 | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|   | (in millions)                                       |  |   |  |
| Cash and Cash Equivalents . . . . .           | \$ 5  | \$ 2   | \$ 3  | \$ —   |
| Equity . . . . .                              | 672   | 150  | 522   | —  |
| Fixed Income . . . . .                        | 603   | 23   | 580   | —  |
| Other Investments . . . . .                   | 38  | —  | 21  | 17   |
| Total assets measured at fair value . . . . . | <u>\$ 1,318</u>                                     | <u>\$ 175</u>  | <u>\$ 1,126</u>   | <u>\$ 17</u>                                       |

For Non-U.S. Defined Benefit Plans assets measured at fair value using significant unobservable inputs (Level 3), the following table summarizes the change in balances during 2014:

|  |              |
|--|--------------|
| Balance, beginning of year . . . . .                   | \$ —         |
| Realized gains . . . . .                               | —            |
| Unrealized gains/(losses) . . . . .                    | 1            |
| Purchases, sales, issuances, and settlements . . . . . | (5)          |
| Transfers in (out) . . . . .                           | 21           |
| Balance, end of year . . . . .                         | <u>\$ 17</u> |

**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**15. RETIREMENT PLANS AND POST-RETIREMENT PENSION PLANS (Continued)**

The table below presents the combined projected benefit obligation (“PBO”), accumulated benefit obligation (“ABO”) and fair value of plan assets, grouping plans using comparisons of the PBO and ABO relative to the plan assets as of October 31, 2014.

|   | <b>Benefit<br/>Obligation<br/>PBO</b> | <b>Fair Value of<br/>Plan Assets</b> |
|---|---------------------------------------|--------------------------------------|
|   | <b>(in millions)</b>                  |                                      |
| U.S. defined benefit plans where PBO exceeds the fair value of plan assets . . . . .                    | \$ 514                                | \$ 491                               |
| U.S. defined benefit plans where fair value of plan assets exceeds PBO . . . . .                        | —                                     | —                                    |
| Total . . . . .   | <u>\$ 514</u>                         | <u>\$ 491</u>                        |
| Non-U.S. defined benefit plans where PBO exceeds or is equal to the fair value of plan assets . . . . . | \$ 1,111                              | \$ 952                               |
| Non-U.S. defined benefit plans where fair value of plan assets exceeds PBO . . . . .                    | 318                                   | 366                                  |
| Total . . . . .   | <u>\$ 1,429</u>                       | <u>\$ 1,318</u>                      |
|   | <b>ABO</b>                            |                                      |
| U.S. defined benefit plans where ABO exceeds the fair value of plan assets . . . . .                    | \$ 5                                  | \$ —                                 |
| U.S. defined benefit plans where the fair value of plan assets exceeds ABO . . . . .                    | 472                                   | 491                                  |
| Total . . . . .   | <u>\$ 477</u>                         | <u>\$ 491</u>                        |
| Non-U.S. defined benefit plans where ABO exceeds or is equal to the fair value of plan assets . . . . . | \$ 1,081                              | \$ 952                               |
| Non-U.S. defined benefit plans where fair value of plan assets exceeds ABO . . . . .                    | 310                                   | 366                                  |
| Total . . . . .   | <u>\$ 1,391</u>                       | <u>\$ 1,318</u>                      |

*Contributions and estimated future benefit payments.* During fiscal year 2015, we do not expect to contribute to the U.S. Defined Benefit Plans, and expect to contribute \$44 million to the Non-U.S. Defined Benefit Plans and \$2 million to the U.S. Post-Retirement Benefit Plan. The following table presents expected future benefit payments for the next 10 years.

|                       | <b>U.S. Defined<br/>Benefit Plans</b> | <b>Non-U.S.<br/>Defined Benefit<br/>Plans</b> | <b>U.S.<br/>Post-Retirement<br/>Benefit Plan</b> |
|-----------------------|---------------------------------------|---|--|
|                       | <b>(in millions)</b>                  |   |  |
| 2015 . . . . .        | \$ 31                                 | \$ 32   | \$ 16  |
| 2016 . . . . .        | \$ 29                                 | \$ 35   | \$ 17  |
| 2017 . . . . .        | \$ 32                                 | \$ 37   | \$ 17  |
| 2018 . . . . .        | \$ 35                                 | \$ 41   | \$ 16  |
| 2019 . . . . .        | \$ 37                                 | \$ 44   | \$ 16  |
| 2020 - 2024 . . . . . | \$ 232                                | \$ 289  | \$ 75  |

*Assumptions.* The assumptions used to determine the benefit obligations and expense for our defined benefit and post-retirement benefit plans are presented in the tables below. The expected long-term return on assets below represents an estimate of long-term returns on investment portfolios

**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**15. RETIREMENT PLANS AND POST-RETIREMENT PENSION PLANS (Continued)**

consisting of a mixture of equities, fixed income and other investments in proportion to the asset allocations of each of our plans. We consider long-term rates of return, which are weighted based on the asset classes (both historical and forecasted) in which we expect our pension and post-retirement funds to be invested. Discount rates reflect the current rate at which pension and post-retirement obligations could be settled based on the measurement dates of the plans—October 31. The U.S. discount rates at October 31, 2014 were determined based on the results of matching expected plan benefit payments with cash flows from a hypothetically constructed bond portfolio. The Non-U.S. rates were generally based on published rates for high-quality corporate bonds. The range of assumptions that were used for the Non-U.S. defined benefit plans reflects the different economic environments within various countries.

Assumptions used to calculate the net periodic benefit cost for the year ended October 31, 2014 were as follows:

U.S. Defined Benefit Plans:

|   |       |
|---|-------|
| Discount rate . . . . .                           | 4.00% |
| Average increase in compensation levels . . . . . | 3.50% |
| Expected long-term return on assets . . . . .     | 8.00% |

Non-U.S. Defined Benefit Plans:

|   |              |
|---|--------------|
| Discount rate . . . . .                           | 1.75 - 4.25% |
| Average increase in compensation levels . . . . . | 2.50 - 3.25% |
| Expected long-term return on assets . . . . .     | 4.00 - 6.50% |

U.S. Post-Retirement Benefits Plan:

|  |       |
|--|-------|
| Discount rate . . . . .  | 4.00% |
| Expected long-term return on assets . . . . .                        | 8.00% |
| Current medical cost trend rate . . . . .                            | 8.00% |
| Ultimate medical cost trend rate . . . . .                           | 3.50% |
| Medical cost trend rate decreases to ultimate rate in year . . . . . | 2028  |

Assumptions used to calculate the benefit obligation as of October 31, 2014 were as follows:

U.S. Defined Benefit Plans:

|   |       |
|---|-------|
| Discount rate . . . . .                           | 4.00% |
| Average increase in compensation levels . . . . . | 3.50% |

Non-U.S. Defined Benefit Plans:

|   |              |
|---|--------------|
| Discount rate . . . . .                           | 1.50 - 4.00% |
| Average increase in compensation levels . . . . . | 2.50 - 3.25% |

U.S. Post-Retirement Benefits Plan:

|  |       |
|--|-------|
| Discount rate . . . . .  | 3.75% |
| Current medical cost trend rate . . . . .                            | 8.00% |
| Ultimate medical cost trend rate . . . . .                           | 3.50% |
| Medical cost trend rate decreases to ultimate rate in year . . . . . | 2028  |

Health care trend rates do not have a significant effect on the total service and interest cost components or on the post-retirement benefit obligation amounts reported for the U.S. Post-Retirement Benefit Plan for the year ended October 31, 2014.

**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**16. GUARANTEES**

*Standard Warranty*

Our standard warranty term for most of our products from the date of delivery is typically three years, which increased from one year in the second quarter of fiscal 2013. We accrue for standard warranty costs based on historical trends in warranty charges as a percentage of net product shipments. The accrual is reviewed regularly and periodically adjusted to reflect changes in warranty cost estimates. Estimated warranty charges are recorded within cost of products at the time related product revenue is recognized. Activity related to the standard warranty accrual, which is included in other accrued and other long-term liabilities in our combined and consolidated balance sheet, is as follows:

|  | <b>Years Ended October 31,</b> |              |
|--|--------------------------------|--------------|
|  | <b>2014</b>                    | <b>2013</b>  |
|  | <b>(in millions)</b>           |              |
| Beginning balance . . . . .                                      | \$ 38                          | \$ 26        |
| Accruals for warranties, including change in estimates . . . . . | 46                             | 44           |
| Settlements made during the period . . . . .                     | (33)                           | (32)         |
| Ending balance . . . . .   | <u>\$ 51</u>                   | <u>\$ 38</u> |
| Accruals for warranties due within one year . . . . .            | \$ 34                          | \$ 21        |
| Accruals for warranties due after one year . . . . .             | 17                             | 17           |
| Ending balance . . . . .   | <u>\$ 51</u>                   | <u>\$ 38</u> |

*Indemnifications to Agilent*

In connection with our separation from Agilent, we agreed to indemnify Agilent against certain damages and expenses that it might incur in the future. These indemnifications primarily cover damages relating to liabilities of the electronic measurement business of Agilent which was contributed to Keysight. Additionally, if the distribution of Keysight common stock to the Agilent shareholders were determined to be taxable for U.S. federal income tax purposes, Agilent and its shareholders that are subject to U.S. federal income tax could incur significant U.S. federal income tax liabilities. If such determination is the result of our taking or failing to take certain actions, then under the tax matters agreement with Agilent, we are generally required to indemnify Agilent against such tax liabilities. Pursuant to the tax matters agreement, we may also be required to indemnify Agilent for other contingent tax liabilities, which could materially adversely affect our financial position. In our opinion, the fair value of these indemnification obligations was not material as of October 31, 2014.

*Indemnifications to Avago*

In connection with the sale of Agilent’s semiconductor products business in December 2005, Agilent agreed to indemnify Avago, its affiliates and other related parties against certain damages and expenses that it might incur in the future. The continuing indemnifications primarily cover damages and expenses 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. In connection with our separation from Agilent, we have agreed to indemnify Agilent in connection with the indemnification obligations of Agilent with respect to Avago. In our opinion, the fair value of these indemnification obligations was not material as of October 31, 2014.

## KEYSIGHT TECHNOLOGIES, INC.

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### 16. GUARANTEES (Continued)

##### *Indemnifications to Verigy*

In connection with the spin-off of Verigy, Agilent agreed to indemnify Verigy and its affiliates against certain damages which it might incur in the future. These indemnifications primarily cover damages relating to liabilities of the businesses that Agilent did not transfer to Verigy, liabilities that might arise under limited portions of Verigy's IPO materials that relate to Agilent, and costs and expenses incurred by Agilent or Verigy to effect the IPO, arising out of the distribution of Agilent's remaining holding in Verigy ordinary shares to Agilent's stockholders, or incurred to effect the separation of the semiconductor test solutions business from Agilent to the extent incurred prior to the separation on June 1, 2006. On July 4, 2011, Verigy announced the completion by Advantest Corporation of its acquisition of Verigy. Verigy operates as a wholly-owned subsidiary of Advantest and Agilent's indemnification obligations to Verigy should be unaffected. In connection with our separation from Agilent, we have agreed to indemnify Agilent in connection with the indemnification obligations of Agilent with respect to Verigy. In our opinion, the fair value of these indemnification obligations was not material as of October 31, 2014.

##### *Indemnifications to Hewlett-Packard*

Agilent has given multiple indemnities to Hewlett-Packard ("HP") in connection with Agilent's activities prior to its spin-off from HP for the businesses that constituted Agilent prior to the spin-off. These indemnifications cover a variety of aspects of Agilent's business, including, but not limited to, employee, tax, intellectual property and environmental matters. The agreements containing these indemnifications have been previously disclosed as exhibits to Agilent's registration statement on Form S-1 filed on August 16, 1999. As part of our separation from Agilent, we have agreed to assume these indemnification obligations of Agilent relating to the electronic measurement business with respect to HP. In our opinion, the fair value of these indemnification obligations was not material as of October 31, 2014.

##### *Indemnifications to Officers and Directors*

Our corporate by-laws require that we indemnify our officers and directors, as well as those who act as directors and officers of other entities at our request, against expenses, judgments, fines, settlements and other amounts actually and reasonably incurred in connection with any proceedings arising out of their services to Keysight and such other entities, including service with respect to employee benefit plans. In addition, we have entered into separate indemnification agreements with each director and each board-appointed officer of Keysight which provide for indemnification of these directors and officers under similar circumstances and under additional circumstances. The indemnification obligations are more fully described in the by-laws and the indemnification agreements. We purchase standard insurance to cover claims or a portion of the claims made against our directors and officers. Since a maximum obligation is not explicitly stated in our by-laws or in our indemnification agreements and will depend on the facts and circumstances that arise out of any future claims, the overall maximum amount of the obligations cannot be reasonably estimated. Historically, we have not made payments related to these obligations, and the fair value for these indemnification obligations was not material as of October 31, 2014.

##### *Other Indemnifications*

As is customary in our industry and as provided for in local law in the U.S. and other jurisdictions, many of our standard contracts provide remedies to our customers and others with whom we enter into contracts, such as defense, settlement, or payment of judgment for intellectual property claims related to



## KEYSIGHT TECHNOLOGIES, INC.

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### 16. GUARANTEES (Continued)

the use of our products. From time to time, we indemnify customers, as well as our suppliers, contractors, lessors, lessees, companies that purchase our businesses or assets and others with whom we enter into contracts, against combinations of loss, expense, or liability arising from various triggering events related to the sale and the use of our products and services, the use of their goods and services, the use of facilities and state of our owned facilities, the state of the assets and businesses that we sell and other matters covered by such contracts, usually up to a specified maximum amount. In addition, from time to time we also provide protection to these parties against claims related to undiscovered liabilities, additional product liability or environmental obligations. In our experience, claims made under such indemnifications are rare and the associated estimated fair value of the liability was not material as of October 31, 2014.

In connection with the previous sales of several of Agilent's businesses, Agilent agreed to indemnify the buyers of such businesses, their respective affiliates and other related parties against certain damages that they might incur in the future. The continuing indemnifications primarily cover damages relating to liabilities of the businesses that Agilent retained and did not transfer to the buyers, as well as other specified items. In connection with our separation from Agilent, we agreed to assume the indemnification obligations of Agilent to the extent that the retained businesses were part of the electronic measurement business. In our opinion, the fair value of these indemnification obligations was not material as of October 31, 2014.

#### 17. COMMITMENTS AND CONTINGENCIES

*Operating Lease Commitments:* We lease certain real and personal property from unrelated third parties under non-cancellable operating leases. Future minimum lease payments under operating leases at October 31, 2014 were \$32 million for 2015, \$29 million for 2016, \$25 million for 2017, \$19 million for 2018, \$16 million for 2019 and \$41 million thereafter. Future minimum sublease income under leases at October 31, 2014 was \$1 million for 2015, \$1 million for 2016, \$1 million for 2017, \$1 million for 2018 and \$1 million for 2019. Certain leases require us to pay property taxes, insurance and routine maintenance, and include escalation clauses. Total rent expense was \$38 million in 2014, \$37 million in 2013 and \$37 million in 2012.

*Contingencies:* We are involved in lawsuits, claims, investigations and proceedings, including, but not limited to, patent, commercial and environmental matters, which arise in the ordinary course of business. There are no matters pending that we currently believe are reasonably possible of having a material impact to our business, combined and consolidated financial condition, results of operations or cash flows.

On March 4, 2013, Agilent made a report to the Inspector General of the Department of Defense ("DOD IG") regarding pricing irregularities relating to certain sales of electronic measurement products (which are now part of the company's business) to U.S. government agencies. Agilent conducted an investigation with the assistance of outside counsel and approached the DOD IG with a proposed methodology for resolving possible overcharges to U.S. government purchasers resulting from these sales and discussed the matter with the Department of Justice ("DOJ"). On October 31, 2014, Agilent resolved the matter with the DOJ and agreed to pay \$849,678 in connection with this resolution (the "Settlement Payment"), which is accrued in 2014. Pursuant to the terms of the previously disclosed Separation and Distribution Agreement, dated as of August 1, 2014 (the "Separation Agreement"), between the company and Agilent, the company reimbursed Agilent for the Settlement Payment.

**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**17. COMMITMENTS AND CONTINGENCIES (Continued)**

As part of routine internal audit activities, Agilent determined that certain employees of Agilent’s subsidiaries in China, including our employees, did not comply with Agilent’s Standards of Business Conduct and other policies. Based on those findings, Agilent has initiated an internal investigation, with the assistance of outside counsel, relating to certain sales of our products through third-party intermediaries in China. The internal investigation includes a review of compliance by our employees in China with the requirements of the U.S. Foreign Corrupt Practices Act and other applicable laws and regulations. On September 5, 2013, Agilent voluntarily contacted the SEC and U.S. Department of Justice to advise both agencies of this internal investigation. On September 15, 2014, Agilent received a letter from the SEC’s Division of Enforcement stating that the investigation had been completed and that the Division of Enforcement did not intend to recommend any enforcement action against Agilent by the SEC. On September 24, 2014, Agilent received a letter from the DOJ stating that the DOJ had closed its inquiry into the matter, citing Agilent’s voluntary disclosure and thorough investigation.

**18. DEBT**

**Short Term Debt**

*Credit Facility*

On September 15, 2014, we entered into a five-year credit agreement, which provides for a \$300 million unsecured credit facility that will expire on November 1, 2019. The company may use amounts borrowed under the facility for general corporate purposes. As of October 31, 2014, the company had no borrowings outstanding under the credit facility. We were in compliance with the covenants of the credit facility during the year ended October 31, 2014.

*Short-Term Loan*

On July 10, 2014, our wholly owned subsidiary in India entered into a short-term loan agreement with a financial institution, which provided up to \$50 million of unsecured borrowings. On July 25, 2014, we borrowed \$35 million against the loan agreement at an interest rate of 9.95 percent per annum. The loan was repaid during the year and as of October 31, 2014, no balance was outstanding.

**Long Term Debt**

The following table summarizes the company’s long-term debt:

|                                       | <b>October 31,</b>   |             |
|---------------------------------------|----------------------|-------------|
|                                       | <b>2014</b>          | <b>2013</b> |
|                                       | <b>(in millions)</b> |             |
| 3.30% Senior Notes due 2019 . . . . . | \$ 499               | \$ —        |
| 4.55% Senior Notes due 2024 . . . . . | 600                  | —           |
| Total . . . . .                       | \$ 1,099             | \$ —        |

*2019 Senior Notes*

In October 2014, the company issued an aggregate principal amount of \$500 million in senior notes (“2019 senior notes”). The 2019 senior notes were issued at 99.902 percent of their principal amount. The

**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**18. DEBT (Continued)**

notes will mature on October 30, 2019, and bear interest at a fixed rate of 3.30 percent per annum. The interest is payable semi-annually on April 30 and October 30 of each year, commencing on April 30, 2015.

*2024 Senior Notes*

In October 2014, the company issued an aggregate principal amount of \$600 million in senior notes (“2024 senior notes”). The 2024 senior notes were issued at 99.966 percent of their principal amount. The notes will mature on October 30, 2024, and bear interest at a fixed rate of 4.55 percent per annum. The interest is payable semi-annually on April 30 and October 30 of each year, commencing on April 30, 2015.

Prior to the Separation, the 2019 and 2024 senior notes and the credit facility were guaranteed on an unsecured, unsubordinated basis by Agilent, which then terminated upon the completion of the Separation of Keysight from Agilent on November 1, 2014. The notes issued are unsecured and rank equally in right of payment with all of Keysight’s other senior unsecured indebtedness. The company incurred issuance costs of \$10 million in connection with the 2019 and 2024 senior notes and credit facility. These costs are included in other assets in the combined and consolidated balance sheet and are being amortized to interest expense over the term of the senior notes and credit facility.

As of October 31, 2014, the company had \$13 million of outstanding letters of credit unrelated to the credit facility that were issued by various lenders.

**19. STOCKHOLDERS’ EQUITY**

**Accumulated other comprehensive income**

The following table summarizes the components of our accumulated other comprehensive income as of October 31, 2014 and 2013, net of tax effect:

|  | October 31,   |       |
|--|---------------|-------|
|  | 2014          | 2013  |
|  | (in millions) |       |
| Unrealized gain on equity securities, net of tax (expense) of \$(4) and \$(3) . . . . .              | \$ 16         | \$ 5  |
| Foreign currency translation, net of tax (expense) of \$(63) and \$(85) . . . . .                    | 6             | 26    |
| Unrealized losses on defined benefit plans, net of tax benefit of \$42 and \$0 . . . . .             | (361)         | —     |
| Unrealized gains (losses) on derivative instruments, net of tax (expense) of \$(2) and \$0 . . . . . | 3             | —     |
| Total accumulated other comprehensive income (loss) . . . . .  | \$ (336)      | \$ 31 |

KEYSIGHT TECHNOLOGIES, INC.

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

19. STOCKHOLDERS' EQUITY (Continued)

Changes in accumulated other comprehensive income by component and related tax effects for the years ended October 31, 2014 and 2013 were as follows:

|   | Unrealized gain on equity securities | Foreign currency translation | Net defined benefit pension cost and post retirement plan costs: |                       | Unrealized gains (losses) on derivatives | Total    |
|---|--------------------------------------|------------------------------|--|-----------------------|--|----------|
|   |                                      |                              | Actuarial Losses   | Prior service credits |  |          |
| (in millions)   |                                      |                              |  |                       |  |          |
| As of October 31, 2012  | \$ —                                 | \$ 101                       | \$ —   | \$ —                  | \$ —                                     | \$ 101   |
| Other comprehensive income (loss) before reclassifications  | 8                                    | (69)                         | —  | —                     | —  | (61)     |
| Tax (expense) benefit   | (3)                                  | (6)                          | —  | —                     | —  | (9)      |
| Other comprehensive income (loss)   | 5                                    | (75)                         | —  | —                     | —  | (70)     |
| As of October 31, 2013(a)   | 5                                    | 26                           | —  | —                     | —  | 31       |
| <i>Pre-Capitalization</i>   |                                      |                              |  |                       |  |          |
| Other comprehensive income (loss) before reclassifications  | 9                                    | (15)                         | —  | —                     | —  | (6)      |
| Tax (expense) benefit   | (3)                                  | 1                            | —  | —                     | —  | (2)      |
| Other comprehensive income (loss) for nine months period ended July 31, 2014(b)                                   | 6                                    | (14)                         | —  | —                     | —  | (8)      |
| <i>Capitalization</i>   |                                      |                              |  |                       |  |          |
| Assumption of accumulated unrealized translation adjustment, losses on pension and other post-employment benefits | —                                    | 31                           | (483)  | 139                   | —  | (313)    |
| Tax (expense) benefit   | 3                                    | 21                           | 77   | (51)                  | —  | 50       |
| Net assumptions(c)  | 3                                    | 52                           | (406)  | 88                    | —  | (263)    |
| <i>Post Capitalization</i>  |                                      |                              |  |                       |  |          |
| Other comprehensive income (loss) before reclassifications  | 3                                    | (58)                         | (60)   | —                     | 5  | (110)    |
| Amounts reclassified out of accumulated other comprehensive income  | —                                    | —                            | 9  | (8)                   | —  | 1        |
| Tax (expense) benefit   | (1)                                  | —                            | 13   | 3                     | (2)                                      | 13       |
| Other comprehensive income (loss) for three months period ended October 31, 2014(d)                               | 2                                    | (58)                         | (38)   | (5)                   | 3  | (96)     |
| As of October 31, 2014(a+b+c+d)   | \$ 16                                | \$ 6                         | \$ (444)   | \$ 83                 | \$ 3                                     | \$ (336) |

KEYSIGHT TECHNOLOGIES, INC.

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

19. STOCKHOLDERS' EQUITY (Continued)

Reclassifications out of accumulated other comprehensive income for the twelve months ended October 31, 2014 were as follows:

| Details about accumulated other comprehensive income components  | Amounts Reclassified from other comprehensive income |      | Affected line item in statement of operations |
|--|--|------|---|
|  | Year Ended October 31,                               |      |   |
|  | 2014   | 2013 |   |
|  | (in millions)  |      |   |
| Net defined benefit pension cost and post retirement plan costs: |  |      |   |
| Actuarial net loss . . . . .                                     | \$ (9)   | \$ — |   |
| Prior service benefit . . . . .                                  | 8  | —    |   |
|  | \$ (1)   | \$ — | Total before income tax                       |
|  | —  | —    | Provision for income tax                      |
|  | \$ (1)   | \$ — | Total net of income tax                       |
| Total reclassifications for the period .                         | \$ (1)   | \$ — |   |

20. SEGMENT INFORMATION

*Description of segments.* We provide core electronic measurement solutions to the communications and electronics industries.

We have two reportable operating segments, measurement solutions and customer support and services. The two operating segments were determined based primarily on how the chief operating decision maker views and evaluates our operations. Operating results are regularly reviewed by the chief operating decision maker to make decisions about resources to be allocated to the segment and to assess its performance. Other factors, including market separation and customer specific applications, go-to-market channels, products and services and manufacturing are considered in determining the formation of these operating segments.

A description of our two reportable segments is as follows:

Our measurement solutions business provides electronic measurement instruments and systems with related software and software design tools that are used in the design, development, manufacture, installation, deployment and operation of electronics equipment. We provide startup assistance, consulting, optimization and application support throughout the customer's product lifecycle.

The customer support and services business provides repair and calibration services for our installed base measurement solutions customers and facilitates the resale of used equipment. Our customer support and services business enables our customers to maximize the value from their electronic measurement equipment and strengthens customer loyalty. Providing these services assures a high level of instrument performance and availability while minimizing the cost of ownership and downtime.

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, collectively called corporate charges, include costs of centralized research and development, legal, accounting, real estate, insurance services, information technology services, treasury

**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**20. SEGMENT INFORMATION (Continued)**

and other corporate infrastructure expenses. Charges are allocated to the segments, and the allocations have been determined on a basis that we consider to be a reasonable reflection of the utilization of services provided to or benefits received by the segments.

The following tables reflect the results of our reportable segments under our management reporting system. These results are not necessarily in conformity with U.S. GAAP. The performance of each segment is measured based on several metrics, including income from operations. These results are used, in part, by the chief operating decision maker in evaluating the performance of, and in allocating resources to, each of the segments.

The profitability of each of the segments is measured after excluding restructuring and asset impairment charges, investment gains and losses, interest income, interest expense, acquisition and integration costs, one-time and pre-separation costs, non-cash amortization and other items as noted in the reconciliations below.

|  | <u>Measurement<br/>Solutions</u> | <u>Customer<br/>Support and<br/>Services</u> | <u>Total<br/>Segments</u> |
|--|----------------------------------|--|---------------------------|
|  | (in millions)                    |  |                           |
| <b>Year ended October 31, 2014:</b>        |                                  |  |                           |
| Total net revenue . . . . .                | \$ 2,533                         | \$ 400                                       | \$ 2,933                  |
| Income from operations . . . . .           | \$ 472                           | \$ 87  | \$ 559                    |
| Depreciation expense . . . . .             | \$ 64                            | \$ 10  | \$ 74                     |
| Share-based compensation expense . . . . . | \$ 36                            | \$ 6   | \$ 42                     |
| <b>Year ended October 31, 2013:</b>        |                                  |  |                           |
| Total net revenue . . . . .                | \$ 2,493                         | \$ 395                                       | \$ 2,888                  |
| Income from operations . . . . .           | \$ 451                           | \$ 93  | \$ 544                    |
| Depreciation expense . . . . .             | \$ 56                            | \$ 9   | \$ 65                     |
| Share-based compensation expense . . . . . | \$ 33                            | \$ 5   | \$ 38                     |
| <b>Year ended October 31, 2012:</b>        |                                  |  |                           |
| Total net revenue . . . . .                | \$ 2,942                         | \$ 373                                       | \$ 3,315                  |
| Income from operations . . . . .           | \$ 669                           | \$ 82  | \$ 751                    |
| Depreciation expense . . . . .             | \$ 49                            | \$ 6   | \$ 55                     |
| Share-based compensation expense . . . . . | \$ 33                            | \$ 4   | \$ 37                     |

KEYSIGHT TECHNOLOGIES, INC.

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

20. SEGMENT INFORMATION (Continued)

The following table reconciles reportable segments' income from operations to our total enterprise income before taxes:

|   | Years Ended October 31, |               |               |
|---|-------------------------|---------------|---------------|
|   | 2014                    | 2013          | 2012          |
|   | (in millions)           |               |               |
| Total reportable segments' income from operations . . . . .                               | \$ 559                  | \$ 544        | \$ 751        |
| Restructuring related costs . . . . .   | 3                       | (15)          | —             |
| Asset impairments . . . . .   | —                       | (1)           | —             |
| Transformational programs . . . . .   | (1)                     | (4)           | (1)           |
| Amortization of intangibles . . . . .   | (8)                     | (9)           | (7)           |
| Acquisition and integration costs . . . . .   | (1)                     | (8)           | (3)           |
| Acceleration of share-based compensation expense related to workforce reduction . . . . . | —                       | (1)           | —             |
| Pre-separation costs . . . . .  | (78)                    | (2)           | —             |
| Other . . . . .   | (5)                     | (8)           | (7)           |
| Interest expense . . . . .  | (3)                     | —             | —             |
| Other income (expense), net . . . . .   | 9                       | 5             | 13            |
| Income before taxes, as reported . . . . .  | <u>\$ 475</u>           | <u>\$ 501</u> | <u>\$ 746</u> |

*Major customers.* No customer represented 10 percent or more of our total net revenue in 2014, 2013 or 2012.

The following table presents assets and capital expenditures directly managed by each segment. Unallocated assets primarily consist of cash, cash equivalents, investments, long-term and other receivables and other assets.

|                                | Measurement Solutions | Customer Support & Services | Total Segments |
|--------------------------------|-----------------------|-----------------------------|----------------|
|                                | (in millions)         |                             |                |
| <b>As of October 31, 2014:</b> |                       |                             |                |
| Assets . . . . .               | \$ 1,740              | \$ 236                      | \$ 1,976       |
| Capital expenditures . . . . . | \$ 60                 | \$ 10                       | \$ 70          |
| <b>As of October 31, 2013:</b> |                       |                             |                |
| Assets . . . . .               | \$ 1,769              | \$ 228                      | \$ 1,997       |
| Capital expenditures . . . . . | \$ 60                 | \$ 9                        | \$ 69          |

**KEYSIGHT TECHNOLOGIES, INC.**

**NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**20. SEGMENT INFORMATION (Continued)**

The following table reconciles segment assets to our total assets:

|   | October 31,     |                 |
|---|-----------------|-----------------|
|   | 2014            | 2013            |
|   | (in millions)   |                 |
| Total reportable segments' assets . . . . .                 | \$ 1,976        | \$ 1,997        |
| Cash, cash equivalents and short-term investments . . . . . | 810             | —               |
| Prepaid expenses . . . . .                                  | 51              | —               |
| Other current assets . . . . .                              | 9               | 8               |
| Investments . . . . .                                       | 63              | 44              |
| Long-term and other receivables . . . . .                   | 33              | 60              |
| Other . . . . .   | 108             | (81)            |
| Total assets . . . . .                                      | <u>\$ 3,050</u> | <u>\$ 2,028</u> |

The other category primarily includes pension assets and also represents the difference between how segments report deferred taxes and intangible assets at the initial purchased amount.

The following table presents summarized information for net revenue and long-lived assets by geographic region. Revenues from external customers are generally attributed to countries based upon the location of the Agilent sales representative. Long lived assets consist of property, plant, and equipment, long-term receivables and other long-term assets excluding intangible assets. The rest of the world primarily consists of rest of Asia and Europe.

|                                   | United States | China  | Japan  | Rest of the World | Total    |
|-----------------------------------|---------------|--------|--------|-------------------|----------|
|                                   | (in millions) |        |        |                   |          |
| Net revenue:                      |               |        |        |                   |          |
| Year ended October 31, 2014 . . . | \$ 1,051      | \$ 590 | \$ 331 | \$ 961            | \$ 2,933 |
| Year ended October 31, 2013 . . . | \$ 966        | \$ 512 | \$ 364 | \$ 1,046          | \$ 2,888 |
| Year ended October 31, 2012 . . . | \$ 1,223      | \$ 611 | \$ 425 | \$ 1,056          | \$ 3,315 |

|                      | United States | Japan  | Malaysia | China | Rest of the World | Total  |
|----------------------|---------------|--------|----------|-------|-------------------|--------|
|                      | (in millions) |        |          |       |                   |        |
| Long-lived assets:   |               |        |          |       |                   |        |
| October 31, 2014 . . | \$ 218        | \$ 157 | \$ 86    | \$ —  | \$ 142            | \$ 603 |
| October 31, 2013 . . | \$ 194        | \$ 122 | \$ 94    | \$ 51 | \$ 60             | \$ 521 |

**21. SUBSEQUENT EVENTS**

On November 1, 2014, we became an independent publicly-traded company through the distribution by Agilent of 100 percent of our outstanding common stock to Agilent's shareholders. Each Agilent shareholder of record as of the close of business on October 22, 2014 received one share of Keysight common stock for every two shares of Agilent common stock held on the record date. Approximately 167 million shares of our common stock were distributed on November 1, 2014 to Agilent shareholders. Keysight's common stock began trading "regular-way" under the ticker symbol "KEYS" on the New York Stock Exchange on November 3, 2014.



## KEYSIGHT TECHNOLOGIES, INC.

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### 21. SUBSEQUENT EVENTS (Continued)

We have entered into various agreements to effect the Separation and provide a framework for our relationship with Agilent, including a separation and distribution agreement, services agreement, a tax matters agreement, an employee matters agreement, an intellectual property matters agreement, a trademark license agreement and a real estate matters agreement. These agreements provide for the allocation between Keysight and Agilent of Agilent's assets, employees, liabilities and obligations (including its investments, property and employee benefits and tax-related assets and liabilities) attributable to periods prior to, at and after our separation from Agilent and will govern certain relationships between Keysight and Agilent after the separation.

Our combined and consolidated financial statements reflect the calculation of certain deferred tax assets and deferred tax liabilities that have been estimated based on a separate return methodology. For periods prior to the Capitalization, the combined and consolidated financial statements include the allocation of certain assets and liabilities that were historically held at the Agilent level but which were specifically identified or allocated to us. As a result of no longer reporting under the separate return methodology, certain current deferred tax assets and deferred tax liabilities will be adjusted to reflect adjusted balances as of the Separation date. We estimate that as of the Separation date, as a result of no longer reporting under the separate return methodology, current deferred tax assets and noncurrent deferred tax assets will decrease by approximately \$4 million and \$24 million, respectively. We are currently evaluating certain deferred tax liability balances related to foreign unremitted earnings, and under the currently existing circumstances, the above estimated amounts do not include an estimate regarding such balances.

Under the terms of the tax matters agreement, current taxes payable for fiscal 2014 will be paid by the legal entity that files the tax return for such tax year. As a result of the Separation, income and other taxes payable is expected to be reduced by \$26 million to adjust the balance to reflect amounts we expect to pay with our 2014 returns. The combined and consolidated financial statements include the allocation of liabilities for uncertain tax positions. As a result of the Separation, other long-term liabilities will be reduced by \$74 million, which reflects the difference between the reserves that were allocated to us in our combined and consolidated financial statements using the separate return methodology.

## QUARTERLY SUMMARY

(Unaudited)

|   | Three Months Ended                   |           |          |             |
|---|--------------------------------------|-----------|----------|-------------|
|   | January 31,                          | April 30, | July 31, | October 31, |
|   | (in millions, except per share data) |           |          |             |
| <b>2014</b>                                       |                                      |           |          |             |
| Net revenue . . . . .                             | \$ 671                               | \$ 743    | \$ 757   | \$ 762      |
| Gross profit . . . . .                            | 372                                  | 415       | 414      | 419         |
| Income from operations . . . . .                  | 91                                   | 127       | 121      | 130         |
| Net income . . . . .                              | \$ 74                                | \$ 110    | \$ 107   | \$ 101      |
| Net income per share—basic and diluted(a) . . . . | \$ 0.44                              | \$ 0.66   | \$ 0.64  | \$ 0.60     |
| Basic and diluted average shares outstanding(a) . | 167                                  | 167       | 167      | 167         |
| <b>2013</b>                                       |                                      |           |          |             |
| Net revenue . . . . .                             | \$ 722                               | \$ 760    | \$ 701   | \$ 705      |
| Gross profit . . . . .                            | 411                                  | 426       | 391      | 395         |
| Income from operations . . . . .                  | 118                                  | 129       | 121      | 128         |
| Net income . . . . .                              | \$ 110                               | \$ 121    | \$ 111   | \$ 115      |
| Net income per share—basic and diluted(a) . . . . | \$ 0.66                              | \$ 0.72   | \$ 0.66  | \$ 0.69     |
| Basic and diluted average shares outstanding(a) . | 167                                  | 167       | 167      | 167         |

(a) On November 1, 2014, Agilent Technologies, Inc. distributed 167 million shares of Keysight common stock to existing holders of Agilent common stock. Basic and diluted net income per share for all periods through October 31, 2014 is calculated using the shares distributed on November 1, 2014. Refer to Note 6 of the combined and consolidated financial statements for information regarding earnings per common share.

## RISKS, UNCERTAINTIES AND OTHER FACTORS THAT MAY AFFECT FUTURE RESULTS

### Risks Related to Our Business

*Depressed and uncertain general economic conditions may adversely affect our operating results and financial condition.*

Our business is sensitive to negative changes in general economic conditions, both inside and outside the United States. The continued economic downturn may adversely impact our business, resulting in:

- reduced demand for our products, delays in the shipment of orders or increases in order cancellations;
- increased risk of excess and obsolete inventories;
- increased price pressure for our products and services; and
- greater risk of impairment to the value, and a detriment to the liquidity, of our future investment portfolio.

*Our operating results and financial condition could be harmed if the markets into which we sell our products decline or do not grow as anticipated.*

Visibility into our markets is limited. Our quarterly sales and operating results are highly dependent on the volume and timing of technology-related spending and orders received during the fiscal quarter, which are difficult to forecast and may be cancelled by our customers. In addition, our revenues and earnings forecasts for future fiscal quarters are often based on the expected seasonality or cyclicity of our markets. However, the markets we serve do not always experience the seasonality or cyclicity that we expect. Any decline in our customers' markets would likely result in a reduction in demand for our products and services. The broader semiconductor market is one of the drivers for our business, and therefore, a decrease in the semiconductor market could harm our business. Also, if our customers' markets decline, we may not be able to collect on outstanding amounts due to us. Such declines could harm our financial position, results of operations, cash flows and stock price, and could limit our profitability. Also, in such an environment, pricing pressures could intensify. Since a significant portion of our operating expenses is relatively fixed in nature due to sales, R&D and manufacturing costs, if we were unable to respond quickly enough, these pricing pressures could further reduce our operating margins.

*If we do not introduce successful new products and services in a timely manner to address increased competition, rapid technological changes and changing industry standards, our products and services will become obsolete, and our operating results will suffer.*

We generally sell our products in industries that are characterized by increased competition through frequent new product and service introductions, rapid technological changes and changing industry standards. In addition, many of the markets in which we operate are seasonal and cyclical. 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 new products and services 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 and on time;
- differentiate our offerings from our competitors' offerings;
- price our products competitively;

- anticipate our competitors' development of new products, services or technological innovations; and control product quality in our manufacturing process.

***Dependence on contract manufacturing and outsourcing other portions of our supply chain may adversely affect our ability to bring products to market and damage our reputation. Dependence on outsourced information technology and other administrative functions may impair our ability to operate effectively.***

As part of our efforts to streamline operations and to cut costs, we outsource aspects of our manufacturing processes and other functions and continue to evaluate additional outsourcing. If our contract manufacturers or other outsourcers fail to perform their obligations in a timely manner or at satisfactory quality levels, our ability to bring products to market and our reputation could suffer. For example, during a market upturn, our contract manufacturers may be unable to meet our demand requirements, which may preclude us from fulfilling our customers' orders on a timely basis. The ability of these manufacturers to perform is largely outside of our control. Additionally, changing or replacing our contract manufacturers or other outsourcees could cause disruptions or delays. In addition, we outsource significant portions of our information technology ("IT") and other administrative functions. Since IT is critical to our operations, any failure to perform on the part of our IT providers could impair our ability to operate effectively. In addition to the risks outlined above, problems with manufacturing or IT outsourcing could result in lower revenues and unrealized efficiencies, and could impact our results of operations and stock price. Much of our outsourcing takes place in developing countries and, as a result, may be subject to geopolitical uncertainty.

***Failure to adjust our purchases due to changing market conditions or failure to estimate our customers' demand could adversely affect our income.***

Our income could be harmed if we are unable to adjust our purchases to market fluctuations, including those caused by the seasonal or cyclical nature of the markets in which we operate. The sale of our products and services are dependent, to a large degree, on customers whose industries are subject to seasonal or cyclical trends in the demand for their products. For example, the consumer electronics market is particularly volatile, making demand difficult to anticipate. During a market upturn, we may not be able to purchase sufficient supplies or components to meet increasing product demand, which could materially affect our results. In the past, we have seen a shortage of parts for some of our products. In addition, some of the parts that require custom design are not readily available from alternate suppliers due to their unique design or the length of time necessary for design work. Should a supplier cease manufacturing 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. In order to secure components for the production of products, we may continue to enter into non-cancellable 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 when demand for communications and electronics products has decreased. If demand for our products is less than we expect, we may experience additional excess and obsolete inventories and be forced to incur additional charges.

***Our operating results may suffer if our manufacturing capacity does not match the demand for our products.***

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. If, during a general market upturn or an upturn in our business, we cannot increase our manufacturing capacity to meet product demand, we will not be able to fulfill orders in a timely manner, which could lead to order cancellations, contract breaches or indemnification obligations. This inability could materially and adversely limit our ability to improve our income, margin and operating results. By contrast, if, during an economic downturn, we had excess

manufacturing capacity, then our fixed costs associated with excess manufacturing capacity would adversely affect our income, margins and operating results.

***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 majority of our total revenue. In addition, many of our employees, contract manufacturers, suppliers, job functions and manufacturing facilities are located outside the United States. 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, economic or other conditions;
- trade protection measures, sanctions, and import or export licensing requirements or restrictions;
- negative consequences from changes in tax laws;
- difficulty in staffing and managing widespread operations;
- differing labor regulations;
- differing protection of intellectual property;
- unexpected changes in regulatory requirements; and
- volatile political environments or geopolitical turmoil, including regional conflicts, terrorism, and war.

We centralize most of our accounting processes at two locations: India and Malaysia. These processes include general accounting, inventory cost accounting, accounts payable and accounts receivables functions. If conditions change in those countries, it may adversely affect operations, including impairing our ability to pay our suppliers. Our results of operations, as well as our liquidity, may be adversely affected and possible delays may occur in reporting financial results.

Additionally, we must comply with complex foreign and U.S. laws and regulations, such as the U.S. Foreign Corrupt Practices Act, the U.K. Bribery Act and other local laws prohibiting corrupt payments to governmental officials, and anti-competition regulations. Violations of these laws and regulations could result in fines and penalties, criminal sanctions, restrictions on our business conduct and on our ability to offer our products in one or more countries, and could also materially affect our brand, ability to attract and retain employees, international operations, business and operating results. Although we plan to implement policies and procedures designed to ensure compliance with these laws and regulations, there can be no assurance that our employees, contractors or agents will not violate these policies and procedures.

In addition, although a substantial amount of our products are priced and paid for in U.S. dollars, many of our products are priced in local currencies and a significant amount of certain types of expenses, such as payroll, utilities, tax and marketing expenses, are paid in local currencies. Our hedging programs are designed to reduce, but not always entirely eliminate, within any given 12-month period, the impact of currency exchange rate movements, including those caused by currency controls, which could impact our business, operating results and financial condition by resulting in lower revenue or increased expenses. However, for expenses beyond a 12-month period, our hedging strategy will not mitigate our exchange rate risk. In addition, our currency hedging programs involve third-party financial institutions as counterparties. The weakening or failure of these counterparties may adversely affect our hedging programs and our

financial condition through, among other things, a reduction in the number of available counterparties, increasingly unfavorable terms or the failure of counterparties to perform under hedging contracts.

***Significant key customers or large orders may expose us to additional business and legal risks that could have a material adverse impact on our operating results and financial condition.***

Certain significant key customers have substantial purchasing power and leverage in negotiating contractual arrangements with us. These customers may demand contract terms that differ considerably from our standard terms and conditions. Large orders may also include severe contractual liabilities for us if we fail to provide the quantity and quality of product at the required delivery times. While we attempt to contractually limit our potential liability under such contracts, we may have to agree to some or all of these types of provisions to secure these orders and to continue to grow our business. Such actions expose us to significant additional risks, which could result in a material adverse impact on our operating results and financial condition.

***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 may not be able to maintain or expand our business. The markets in which we operate are dynamic, and we may need to respond with reorganizations, workforce reductions and site closures from time to time. We believe our pay levels are competitive within the regions that we operate. However, there is also intense competition for certain highly technical specialties in geographic areas in which we operate, and it may become more difficult to retain key employees.

***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 HP for subsurface contaminations that were known at the time of Agilent's separation from HP in 1999. In connection with Agilent's separation from HP, HP and Agilent entered into an agreement pursuant to which HP agreed to retain the liability for this subsurface contamination, perform the required remediation and indemnify Agilent with respect to claims arising out of that contamination. Agilent has assigned its rights and obligations under this agreement to Keysight in respect of facilities transferred to us in the separation. As a result, HP will have access to a limited number of our properties to perform remediation. Although HP agreed to minimize interference with on-site operations at such 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. In connection with the separation, Agilent will indemnify us directly for any liabilities related thereto. We cannot be sure that HP will continue to fulfill its remediation obligations or that Agilent will continue to fulfill its indemnification obligations.

In connection with the separation, Agilent also agreed to indemnify us for any liability associated with contamination from past operations at all properties transferred from Agilent to Keysight. We cannot be sure that Agilent will fulfill its indemnification obligations.

Our current manufacturing processes involve the use of substances regulated under various international, federal, state and local laws governing the environment. As a result, we may become 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 United States, even if the sites outside the United States are not subject to regulations imposed by foreign governments, we may not be aware of all conditions that could subject us to liability.

***We and our customers 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.***

We and our customers 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. If demand for our products is adversely affected or our costs increase, our business would suffer.

Our products and operations are also often subject to the rules of industrial standards bodies, like the International Standards Organization, as well as regulation by 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.

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

From time to time, third parties may claim that one or more of our products or services infringe their intellectual property rights. We analyze and take action in response to such claims on a case-by-case basis. Any dispute or litigation regarding patents or other intellectual property could be costly and time-consuming due to the complexity of our technology and the uncertainty of intellectual property litigation and could divert our management and key personnel from business operations. A claim of intellectual property infringement could cause us to enter into a costly or restrictive license agreement (which may not be available under acceptable terms, or at all), require us to redesign certain of our products (which would be costly and time-consuming) and/or subject us to significant damages or an injunction against the development and sale of certain products or services. In certain of our businesses, we rely on third-party intellectual property licenses, and we cannot ensure that these licenses will be available to us in the future on terms favorable to us or at all.

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

Our success depends in part on our proprietary technology, including technology we obtained through acquisitions. We rely on various intellectual property rights, including patents, copyrights, trademarks and trade secrets, as well as confidentiality provisions and licensing arrangements, to establish our proprietary rights. If we do not enforce our intellectual property rights successfully, our competitive position may suffer, which could harm our operating results.

Our pending patent, copyright and trademark registration applications may not be allowed or competitors may challenge the validity or scope of our patents, copyrights or trademarks. In addition, our patents, copyrights, trademarks and other intellectual property rights may not provide us with a significant competitive advantage. In preparation for the separation and distribution, we have applied for trademarks related to our new global brand name in various jurisdictions worldwide. Any successful opposition to our applications in material jurisdictions could impose material costs on us or make it more difficult to protect our brand. Different jurisdictions vary widely in the level of protection and priority they give to trademark and other intellectual property rights.

We may be required to spend significant resources monitoring our intellectual property rights, and we may or may not be able to detect infringement of such rights by third parties. Our competitive position may be harmed if we cannot detect infringement and enforce our intellectual property rights in a timely

manner, or at all. In some circumstances, we may choose to not pursue enforcement due to a variety of reasons. In addition, competitors may avoid infringement by designing around our intellectual property rights or by developing non-infringing competing technologies. Intellectual property rights and our ability to enforce them may be unavailable or limited in some countries, which could make it easier for competitors to capture market share and could result in lost revenues to the company. Furthermore, some of our intellectual property is licensed to others, which allows them to compete with us using that intellectual property.

***We are or will be subject to ongoing tax examinations of our tax returns by the IRS and other tax authorities. An adverse outcome of any such audit or examination by the IRS or other tax authority could have a material adverse effect on our results of operations, financial condition and liquidity.***

We are or will be subject to ongoing tax examinations of our tax returns by the IRS and other tax authorities in various jurisdictions. We regularly assess the likelihood of adverse outcomes resulting from ongoing tax examinations to determine the adequacy of our provision for income taxes. These assessments can require considerable estimates and judgments. Intercompany transactions associated with the sale of inventory, services, intellectual property and cost sharing arrangements are complex and affect our tax liabilities. The calculation of our tax liabilities involves uncertainties in the application of complex tax laws and regulations in multiple jurisdictions. The outcomes of any tax examinations could have an adverse effect on our operating results and financial condition. Due to the complexity of tax contingencies, the ultimate resolution of any tax matters related to operations post-separation may result in payments greater or less than amounts accrued.

Our effective tax rate may be adversely impacted by, among other things, changes in the mix of our earnings among countries with differing statutory tax rates, changes in the valuation allowance of deferred tax assets and changes in tax laws. We cannot give any assurance as to what our effective tax rate will be in the future because of, among other things, uncertainty regarding the tax policies of the jurisdictions where we operate. In addition, we may be impacted by changes in tax laws, including tax rate changes, changes to the laws related to the treatment and remittance of foreign earnings, new tax laws and subsequent interpretations of tax law in the United States and other jurisdictions.

***If tax incentives change or cease to be in effect, our income taxes could increase significantly.***

We benefit from tax incentives extended to our foreign subsidiaries to encourage investment or employment. Several jurisdictions have granted or are anticipated to grant us tax incentives that require renewal at various times in the future, the most significant being in Singapore. We do not expect incentives granted by other tax authorities to have a material impact on the financial statements. The specific conditions of the tax incentives with Singapore are being negotiated and have not been finally agreed. However, we expect that these conditions will be different from those currently agreed between Agilent and Singapore, and will include achieving different thresholds of employment, ownership of certain assets as well as specific types of investment activities within Singapore. We believe that we will satisfy such conditions in the future.

Our taxes could increase if the incentives are not granted or renewed upon expiration. If we cannot or do not wish to satisfy all or portions of the tax incentive conditions, we may lose the related tax incentive and could be required to refund tax incentives previously realized. As a result, our effective tax rate could be higher than it would have been had we maintained the benefits of the tax incentives.

***If we suffer a loss to our factories, facilities or distribution system due to a catastrophic event, our operations could be significantly harmed.***

Our factories, facilities and distribution system are subject to catastrophic loss due to fire, flood, terrorism or other natural or manmade disasters. In particular, several of our facilities could be subject to a catastrophic loss caused by earthquake or other natural disasters due to their locations. For example, our



production facilities, headquarters and laboratories in California and our production facilities in 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. If such a disruption were to occur, we could breach our agreements, our reputation could be harmed and our business and operating results could be adversely affected. In addition, since we have consolidated our manufacturing facilities, we are more likely to experience an interruption to our operations in the event of a catastrophe in any one location. 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. Also, our third-party insurance coverage will vary from time to time in both type and amount depending on availability, cost and our decision with respect to risk retention. Economic conditions and uncertainties in global markets may adversely affect the cost and other terms upon which we are able to obtain third-party insurance. If our third-party insurance coverage is adversely affected, or to the extent we have elected to self-insure, we may be at a greater risk that our operations will be harmed by a catastrophic loss.

***As we build our information technology infrastructure and transition our data to our own system, if we experience a significant disruption in, or breach in security of, our information technology systems, or if we fail to implement new systems and software successfully, our business could be adversely affected.***

We are in the process of transitioning from Agilent's information technology system to our own system during the first half of fiscal year 2015. We rely on several centralized information technology systems to provide products and services, maintain financial records, process orders, manage inventory, process shipments to customers and operate other critical functions. If we cannot transition effectively from Agilent's existing system and were to experience a prolonged system disruption in the information technology systems that involve our interactions with customers or suppliers, it could result in the loss of sales and customers and significant incremental costs, which could adversely affect our business. In addition, our information technology systems may be susceptible to damage, disruptions or shutdowns due to power outages, hardware failures, computer viruses, attacks by computer hackers, telecommunication failures, user errors, catastrophes or other unforeseen events. Furthermore, security breaches of our information technology systems could result in the misappropriation or unauthorized disclosure of confidential information belonging to the company or our employees, partners, customers or suppliers, which could result in significant financial or reputational damage to the company.

***Our business and financial results may be adversely affected by various legal and regulatory proceedings.***

We are subject to legal proceedings, lawsuits and other claims in the normal course of business and could become subject to additional claims in the future, some of which could be material. The outcome of existing proceedings, lawsuits and claims may differ from our expectations because the outcomes of litigation are often difficult to reliably predict. Various factors or developments can lead us to change current estimates of liabilities and related insurance receivables where applicable, or permit us to make such estimates for matters previously not susceptible to reasonable estimates, such as a significant judicial ruling or judgment, a significant settlement, significant regulatory developments or changes in applicable law. A future adverse ruling, settlement or unfavorable development could result in charges that could adversely affect our business, operating results or financial condition.

***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 may 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 our own or the investment community's expectations in a given fiscal quarter, or over the long term. If market conditions or other factors lead us to change our strategic direction, we may not realize the expected value from such transactions. Further, such transactions often

have post-closing arrangements, including, but not limited to, post-closing adjustments, transition services, escrows or indemnifications, the financial results of which can be difficult to predict. 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 businesses or product lines to realize the value from expected synergies. Depending on the size and complexity of an acquisition, the successful integration of the entity depends on a variety of factors, including:

- the retention of key employees and/or customers;
- the management of facilities and employees in different geographic areas; and
- the compatibility of our infrastructure, policies and organizations with those of the acquired company.

If we do not realize the expected benefits or synergies of such transactions, our combined and consolidated financial position, results of operations, cash flows and stock price could be negatively impacted.

In addition, effective internal controls are necessary for us to provide reliable and accurate financial reports and to effectively prevent fraud. We anticipate devoting significant resources and time to comply with the internal control over financial reporting requirements of the Sarbanes-Oxley Act of 2002. However, we cannot be certain that these measures will ensure that we design, implement and maintain adequate control over our financial processes and reporting in the future, especially in the context of acquisitions of other businesses. Any difficulties in the assimilation of acquired businesses into our control system could harm our operating results or cause us to fail to meet our financial reporting obligations. Inferior internal controls could also cause investors to lose confidence in our reported financial information, which could have a negative effect on the trading price of our stock and our access to capital. All of these efforts require varying levels of management resources, which may divert our attention from other business operations.

***We have substantial cash requirements in the United States, although most of our cash is generated outside of the United States. The failure to maintain a level of cash sufficient to address our cash requirements in the United States could adversely affect our financial condition and results of operations.***

Although the cash generated in the United States from our operations, including any cash and non-permanently invested earnings repatriated to the United States, is expected to cover our normal operating requirements and debt service requirements, a substantial amount of additional cash may be required for special purposes such as the maturity of our current and future debt obligations, any dividends that may be declared, any future stock repurchase programs and any acquisitions. If we encounter a significant need for liquidity domestically or at a particular location that we cannot fulfill through borrowings, equity offerings or other internal or external sources, we may incur unfavorable tax and earnings consequences. These adverse consequences would occur, for example, if the transfer of cash into the United States is taxed and no foreign tax credit is available to offset the U.S. tax liability, resulting in higher taxes. Foreign exchange ceilings imposed by local governments and the sometimes lengthy approval processes that foreign governments require for international cash transfers may delay our internal cash transfers from time to time. These factors may cause us to have an overall tax rate higher than our tax rates have been in the past. Our business, operating results, financial condition and strategic initiatives could be adversely impacted if we are unable to address our U.S. cash requirements through the efficient and timely repatriations of overseas cash or other sources of cash obtained at a cost and on other terms acceptable to us.

***We have outstanding debt and may incur other debt in the future, which could adversely affect our financial condition, liquidity and results of operations.***

We currently have outstanding debt as well as availability to borrow under a revolving credit facility. We may borrow additional amounts in the future and use the proceeds from any future borrowing for general corporate purposes, future acquisitions, expansion of our business or repurchases of our outstanding shares of common stock.

Our incurrence of this debt, and increases in our aggregate levels of debt, may adversely affect our operating results and financial condition by, among other things:

- requiring a portion of our cash flow from operations to make interest payments on this debt;
- increasing our vulnerability to general adverse economic and industry conditions;
- reducing the cash flow available to fund capital expenditures and other corporate purposes and to grow our business; and
- limiting our flexibility in planning for, or reacting to, changes in our business and the industry.

Our current revolving credit facility imposes restrictions on us, including restrictions on our ability to create liens on our assets and the ability of our subsidiaries to incur indebtedness, and requires us to maintain compliance with specified financial ratios. Our ability to comply with these ratios may be affected by events beyond our control. In addition, the indenture governing our senior notes contains covenants that may adversely affect our ability to incur certain liens or engage in certain types of sale and leaseback transactions. If we breach any of the covenants and do not obtain a waiver from the lenders, then, subject to applicable cure periods, our outstanding indebtedness could be declared immediately due and payable.

***We may need additional financing in the future to meet our capital needs or to make opportunistic acquisitions, and such financing may not be available on terms favorable to us, if at all, and may be dilutive to existing shareholders.***

We may need to seek additional financing for our general corporate purposes. For example, we may need to increase our investment in R&D activities or need funds to make acquisitions. We may be unable to obtain any desired additional financing on terms favorable to us, if at all. If adequate funds are not available on acceptable terms, we may be unable to fund our expansion, successfully develop or enhance products or respond to competitive pressures, any of which could negatively affect our business. If we raise additional funds through the issuance of equity securities, our shareholders will experience dilution of their ownership interest. If we raise additional funds by issuing debt, we may be subject to further limitations on our operations and ability to pay dividends due to restrictive covenants.

***Adverse conditions in the global banking industry and credit markets may adversely impact the value of our cash investments or impair our liquidity.***

As of the distribution, we had cash and cash equivalents of approximately \$810 million invested or held in a mix of money market funds, time deposit accounts and bank demand deposit accounts. Disruptions in the financial markets may, in some cases, result in an inability to access assets such as money market funds that traditionally have been viewed as highly liquid. Any failure of our counterparty financial institutions or funds in which we have invested may adversely impact our cash and cash equivalent positions and, in turn, our results and financial condition.

***Future investment returns on pension assets may be lower than expected or interest rates may decline, requiring us to make significant additional cash contributions to our future plans.***

We sponsor several defined benefit pension plans that cover many of our salaried and hourly employees. The Federal Pension Protection Act of 2006 requires that certain capitalization levels be maintained in each of the U.S. plans and there may be similar funding requirements in the plans outside the United States. Because it is unknown what the investment return on pension assets will be in future

years or what interest rates may be at any point in time, no assurances can be given that applicable law will not require us to make future material plan contributions. Any such contributions could adversely affect our financial condition.

### **Risks Related to the Separation**

***We have no history of operating as an independent company, and our historical financial information is not necessarily representative of the results that we would have achieved as a separate, publicly-traded company and may not be a reliable indicator of our future results.***

The historical information about the company prior to fiscal year 2015 refers to our business as operated by and integrated with Agilent. Our historical financial information included in this Form 10-K is derived from the consolidated financial statements and accounting records of Agilent. Accordingly, the historical financial information does not necessarily reflect the financial condition, results of operations or cash flows that we would have achieved as a separate, publicly-traded company during the periods presented or those that we will achieve in the future primarily as a result of the factors described below:

- prior to the separation, our business has been operated by Agilent as part of its broader corporate organization, rather than as an independent company. Agilent or one of its affiliates performed various corporate functions for us such as legal, treasury, accounting, auditing, human resources, corporate affairs and finance. Our historical financial results reflect allocations of corporate expenses from Agilent for such functions and are likely to be less than the expenses we would have incurred had we operated as a separate publicly-traded company. Following the separation, our cost related to such functions previously performed by Agilent may therefor increase;
- our business was integrated with the other businesses of Agilent. Historically, we shared economies of scope and scale in costs, employees, vendor relationships and customer relationships. Although our transition agreements with Agilent took effect upon the separation, these arrangements may not fully capture the benefits that we enjoyed as a result of being integrated with Agilent and may result in the company paying higher charges than in the past for these services. This could have an adverse effect on our results of operations and financial condition following the separation;
- generally, our working capital requirements and capital for our general corporate purposes, including acquisitions and capital expenditures, have historically been satisfied as part of the corporate-wide cash management policies of Agilent. Following the separation, we may need to obtain additional financing from banks, through public offerings or private placements of debt or equity securities, strategic relationships or other arrangements;
- after the separation, the cost of capital for our business may be higher than Agilent's cost of capital prior to the separation; and
- our historical financial information does not reflect the debt or the associated interest expense that we have incurred as part of the separation and distribution.

Other significant changes may occur in our cost structure, management, financing and business operations as a result of operating as a company separate from Agilent. For additional information about the past financial performance of our business and the basis of presentation of the historical combined and consolidated financial statements, see "Selected Historical Combined and Consolidated Financial Data," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the historical financial statements and accompanying notes included elsewhere in this Form 10-K.

***Potential indemnification liabilities to Agilent pursuant to the separation and distribution agreement could materially and adversely affect our business, financial condition, results of operations and cash flows.***

The separation and distribution agreement provides for, among other things, indemnification obligations designed to make us financially responsible for any liabilities associated with assets used by our

business; our failure to pay, perform or otherwise promptly discharge any such liabilities or contracts, in accordance with their respective terms, whether prior to, at or after the distribution; any guarantee, indemnification obligation, surety bond or other credit support agreement, arrangement, commitment or understanding by Agilent for our benefit, unless they are liabilities related to assets used in the Agilent business; any breach by us of the separation agreement or any of the ancillary agreements or any action by us in contravention of our amended and restated certificate of incorporation or amended and restated bylaws; and any untrue statement or alleged untrue statement of a material fact or omission or alleged omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, with respect to all information contained in the registration statement or any other disclosure document that describes the separation or the distribution or the company and its subsidiaries or primarily relates to the transactions contemplated by the separation and distribution agreement, subject to certain exceptions. If we are required to indemnify Agilent under the circumstances set forth in the separation and distribution agreement, we may be subject to substantial liabilities.

***In connection with our separation from Agilent, Agilent will indemnify us for certain liabilities. However, there can be no assurance that the indemnity will be sufficient to insure us against the full amount of such liabilities, or that Agilent's ability to satisfy its indemnification obligation will not be impaired in the future.***

Pursuant to the separation and distribution agreement and certain other agreements with Agilent, Agilent agreed to indemnify us for certain liabilities. However, third parties could also seek to hold us responsible for any of the liabilities that Agilent has agreed to retain, and there can be no assurance that the indemnity from Agilent will be sufficient to protect us against the full amount of such liabilities, or that Agilent will be able to fully satisfy its indemnification obligations. In addition, Agilent's insurers may attempt to deny us coverage for liabilities associated with certain occurrences of indemnified liabilities prior to the separation. Moreover, even if we ultimately succeed in recovering from Agilent or such insurance providers any amounts for which we are held liable, we may be temporarily required to bear these losses. Each of these risks could negatively affect our business, financial position, results of operations and cash flows.

***We will be subject to continuing contingent liabilities of Agilent following the separation.***

After the separation, there will be several significant areas where the liabilities of Agilent may become our obligations. For example, under the Code and the related rules and regulations, each corporation that was a member of the Agilent U.S. consolidated group during a taxable period or portion of a taxable period ending on or before the effective time of the distribution is severally liable for the U.S. federal income tax liability of the entire Agilent U.S. consolidated group for that taxable period. Consequently, if Agilent is unable to pay the consolidated U.S. federal income tax liability for a prior period, we could be required to pay the entire amount of such tax, which could be substantial and in excess of the amount allocated to it under the tax matters agreement between us and Agilent. Other provisions of federal law establish similar liability for other matters, including laws governing tax-qualified pension plans, as well as other contingent liabilities.

***There could be significant liability if the distribution is determined to be a taxable transaction.***

A condition to the distribution is that Agilent received an opinion of Baker & McKenzie LLP, tax counsel to Agilent, regarding the qualification of the separation and the distribution as a reorganization within the meaning of Sections 355(a) and 368(a)(1)(D) of the Code. The opinion relies on certain facts, assumptions, representations and undertakings from Agilent and Keysight, including those regarding the past and future conduct of the companies' respective businesses and other matters. If any of these facts, assumptions, representations or undertakings are incorrect or not satisfied, Agilent and its shareholders may not be able to rely on the opinion, and could be subject to significant tax liabilities. Notwithstanding the opinion of tax counsel, the IRS could determine on audit that the distribution is taxable if it determines

that any of these facts, assumptions, representations or undertakings are not correct or have been violated or if it disagrees with the conclusions in the opinion.

If the distribution were determined to be taxable for U.S. federal income tax purposes, Agilent and its shareholders that are subject to U.S. federal income tax could incur significant U.S. federal income tax liabilities. For example, if the distribution failed to qualify for tax-free treatment, Agilent would for U.S. federal income tax purposes be treated as if it had sold the Keysight common stock in a taxable sale for its fair market value, and Agilent's shareholders, who are subject to U.S. federal income tax, would be treated as receiving a taxable distribution in an amount equal to the fair market value of the Keysight common stock received in the distribution. In addition, if the separation and distribution failed to qualify for tax-free treatment under federal, state and local tax law and/or foreign tax law, Agilent (and, under the tax matters agreement described below, Keysight) could incur significant tax liabilities under U.S. federal, state, local and/or foreign tax law.

Under the tax matters agreement between Agilent and Keysight, we are generally required to indemnify Agilent against taxes incurred by Agilent that arise as a result of our taking or failing to take, as the case may be, certain actions that result in the distribution failing to meet the requirements of a tax-free distribution under Section 355 of the Code. Under the tax matters agreement between Agilent and Keysight, we may also be required to indemnify Agilent for other contingent tax liabilities, which could materially adversely affect our financial position.

***We may not be able to engage in certain corporate transactions for a two-year period after the separation.***

To preserve the tax-free treatment for U.S. federal income tax purposes to Agilent of the separation and distribution, under the tax matters agreement that we have entered into with Agilent, we will be restricted from taking any action that prevents the separation and distribution from being tax-free for U.S. federal income tax purposes. Under the tax matters agreement, for the two-year period following the distribution, we are prohibited, except in certain circumstances, from entering into acquisition, merger, liquidation, sale and stock redemption transactions with respect to our stock if such transactions, taken as a whole, would result in one or more persons acquiring forty percent (40%) or more of the outstanding Keysight stock.

These restrictions may limit our ability to pursue certain strategic transactions or other transactions that it may believe to be in the best interests of our shareholders or that might increase the value of our business. In addition, under the tax matters agreement, we may be required to indemnify Agilent against any such tax liabilities as a result of the acquisition of Keysight's stock or assets, even if we did not participate in or otherwise facilitate the acquisition.

***Our accounting and other management systems and resources may not be adequately prepared to meet the financial reporting and other requirements to which we are subject as an independent, publicly-traded company.***

Our financial results previously were included within the consolidated results of Agilent, and we believe that our financial reporting and internal controls were appropriate for those of subsidiaries of a public company. However, we were not directly subject to the reporting and other requirements of the Exchange Act. As an independent, publicly-traded company, we are subject to reporting and other obligations under the Exchange Act, and we are required to comply with Section 404 of the Sarbanes-Oxley Act of 2002 (the “Sarbanes-Oxley Act”), which will require annual management assessments of the effectiveness of our internal control over financial reporting. The Sarbanes-Oxley Act also requires that we obtain a report by our independent registered public accounting firm expressing an opinion on the effectiveness of our internal control over financial reporting. These reporting and other obligations may place significant demands on our management, administrative and operational resources, including accounting systems and resources.

The Exchange Act requires that we file annual, quarterly and current reports with respect to our business and financial condition. Under the Sarbanes-Oxley Act, we are required to maintain effective disclosure controls and procedures and internal controls over financial reporting. We expect to incur additional annual expenses for the purpose of addressing these requirements, and those expenses may be significant. If we are unable to upgrade our financial and management controls, reporting systems, information technology systems and procedures in a timely and effective fashion, our ability to comply with our financial reporting requirements and other rules that apply to reporting companies under the Exchange Act could be impaired. Any failure to achieve and maintain effective internal controls could have a material adverse effect on our business, financial condition, results of operations or cash flows.

***Certain of our executive officers and directors may have actual or potential conflicts of interest because of their equity interest in Agilent and because certain converted Keysight performance share awards held by them will be earned based on the performance of Agilent.***

The ownership by our executive officers and some of our directors of common shares of Agilent may create, or may create the appearance of, conflicts of interest. Because of their current or former positions with Agilent, certain of our executive officers and directors own Agilent common shares. The individual holdings of common shares may be significant for some of these persons compared to these persons’ total assets. Further, the fact that our executive officers hold certain converted Keysight performance share awards which will be earned based on Agilent’s performance may create, or may create the appearance of, conflicts of interest. Specifically, the outstanding Agilent performance share awards with a fiscal year 2013-2015 performance period held by our executive officers were converted into performance share awards with respect to Keysight common stock upon the separation, but will continue to be subject, for the remainder of the performance period, to the same performance criteria (Agilent total shareholder return) as applied immediately prior to the separation. Even though our board of directors consist of a majority of directors who are independent, and our executive officers ceased to be employees of Agilent upon the separation, continuing ownership of Agilent common shares by our executive officers and some of our directors, and continued application of performance criteria based on Agilent total shareholder return to certain converted Keysight performance share awards held by our executive officers, could create, or appear to create, potential conflicts of interest if Keysight and Agilent pursue the same corporate opportunities or face decisions that could have different implications for Keysight and Agilent.

***We may not achieve some or all of the expected benefits of the separation, and the separation may adversely affect our business.***

We may not be able to achieve the full strategic and financial benefits expected to result from the separation, or such benefits may be delayed or not occur at all. The separation and distribution is expected to provide the following benefits, among others:

- a distinct investment identity allowing investors to evaluate the merits, performance and future prospects of Keysight separately from Agilent;
- more effective pursuit of each company's distinct operating priorities and strategies;
- more efficient allocation of capital for both Agilent and Keysight;
- direct access by Keysight to the capital markets; and
- facilitation of incentive compensation arrangements for employees more directly tied to the performance of the relevant company's business, and potential enhancement of employee hiring and retention by, among other things, improving the alignment of management and employee incentives with performance and growth objectives, while at the same time creating an independent equity structure that will facilitate our ability to affect future acquisitions utilizing Keysight common stock.

We may not achieve these and other anticipated benefits for a variety of reasons, including, among others: (i) the separation will require significant amounts of management's time and effort, which may divert management's attention from operating and growing our business; (ii) following the separation, we may be more susceptible to market fluctuations and other adverse events than if we were still a part of Agilent; (iii) following the separation, our business will be less diversified and have less scale than Agilent's business prior to the separation; and (iv) the other actions required to separate Agilent's and our respective businesses could disrupt our operations. If we fail to achieve some or all of the benefits expected to result from the separation, or if such benefits are delayed, our business, operating results and financial condition could be adversely affected.

***Keysight or Agilent may fail to perform under various transaction agreements that have been executed as part of the separation, or we may fail to have necessary systems and services in place when certain of the transaction agreements expire.***

In connection with the separation, Keysight and Agilent have entered into a separation agreement and various other agreements, including a services agreement, a tax matters agreement, an employee matters agreement, an intellectual property matters agreement, a trademark license agreement and a real estate matters agreement. The separation agreement, tax matters agreement, employee matters agreement, intellectual property matters agreement, trademark license agreement and real estate matters agreement determine the allocation of assets and liabilities between the companies following the separation for those respective areas and include any necessary indemnifications related to liabilities and obligations. The services agreement provides for the performance of certain services by each company for the benefit of the other for a period of time after the separation. We will rely on Agilent to satisfy its performance and payment obligations under these agreements. If Agilent is unable to satisfy its obligations under these agreements, including its indemnification obligations, we could incur operational difficulties or losses. If we do not have in place our own systems and services, or if we do not have agreements with other providers of these services once certain transaction agreements expire, we may not be able to operate our business effectively and our profitability may decline. We are in the process of creating our own, or engaging third parties to provide, systems and services to replace many of the systems and services that Agilent currently provides to us. However, we may not be successful in implementing these systems and services or in transitioning data from Agilent's systems to our own.



***As we build our information technology infrastructure and transition our data to our own systems, we could incur substantial additional costs and experience temporary business interruptions.***

We expect to install and implement information technology infrastructure to support our critical business functions, including accounting and reporting, manufacturing process control, customer service, inventory control and distribution. We may incur temporary interruptions in business operations if we cannot transition effectively from Agilent's existing transactional and operational systems, data centers and the transition services that support these functions as we replace these systems. We may not be successful in implementing our new systems and transitioning our data, and we may incur substantially higher costs for implementation than currently anticipated. Our failure to avoid operational interruptions as we implement the new systems and replace Agilent's information technology services, or our failure to implement the new systems and replace Agilent's services successfully, could disrupt our business, adversely affect our ability to collect receivables from customers, and have a material adverse effect on our profitability. In addition, if we are unable to replicate or transition certain systems, our ability to comply with regulatory requirements could be impaired.

***The one-time and ongoing costs of the spin-off may be greater than we expected.***

We will incur costs in connection with our transition to being a stand-alone public company that relate primarily to accounting, tax, legal and other professional costs; financing costs in connection with obtaining our financing as a stand-alone company; compensation, such as modifications to certain incentive awards upon completion of the spin-off; recruiting and relocation costs associated with hiring our senior management personnel; and costs to separate assets and information systems. These costs, whether incurred before or after the spin-off, may be greater than anticipated and could have a material adverse effect on our business, financial condition, results of operations and cash flows.

***Potential liabilities may arise due to fraudulent transfer considerations, which would adversely affect our financial condition and our results of operations.***

In connection with the separation and distribution, Agilent has undertaken and will undertake several corporate restructuring transactions which, along with the separation and distribution, may be subject to federal and state fraudulent conveyance and transfer laws. If, under these laws, a court were to determine that, at the time of the separation and distribution, any entity involved in these restructuring transactions or the separation and distribution:

- was insolvent;
- was rendered insolvent by reason of the separation and distribution;
- had remaining assets constituting unreasonably small capital; or
- intended to incur, or believed it would incur, debts beyond its ability to pay these debts as they matured,

then the court could void the separation and distribution, in whole or in part, as a fraudulent conveyance or transfer. The court could then require our shareholders to return to Agilent some or all of the shares of Keysight common stock issued in the distribution, or require Agilent or Keysight, as the case may be, to fund liabilities of the other company for the benefit of creditors. The measure of insolvency will vary depending upon the jurisdiction whose law is being applied. Generally, however, an entity would be considered insolvent if the fair value of its assets was less than the amount of its liabilities or if it incurred debt beyond its ability to repay the debt as it matures.

## **Risks Related to Our Common Stock**

### ***Our share price may fluctuate significantly.***

Our common stock is listed on NYSE under the ticker symbol “KEYS.” The market price of our common stock may fluctuate widely, depending on many factors, some of which may be beyond our control, including:

- actual or anticipated fluctuations in our operating results due to factors related to our business;
- success or failure of our business strategy;
- our quarterly or annual earnings, or those of other companies in our industry;
- our ability to obtain third-party financing as needed;
- announcements by us or our competitors of significant acquisitions or dispositions;
- changes in accounting standards, policies, guidance, interpretations or principles;
- the failure of securities analysts to cover our common stock;
- changes in earnings estimates by securities analysts or our ability to meet those estimates;
- the operating and share price performance of other comparable companies;
- investor perception of our company;
- natural or other disasters that investors believe may affect us;
- overall market fluctuations;
- results from any material litigation or government investigations;
- changes in laws or regulations affecting our business; and
- general economic conditions and other external factors.

Stock markets in general have experienced volatility that has often been unrelated to the operating performance of a particular company. These broad market fluctuations could adversely affect the trading price of our common stock.

In addition, when the market price of a company’s shares drops significantly, shareholders often institute securities class action lawsuits against the company. A lawsuit against us could cause us to incur substantial costs and could divert the time and attention of management and other resources.

### ***We cannot guarantee the payment of dividends on our common stock, or the timing or amount of any such dividends.***

We do not currently expect to pay dividends on our common stock. The payment of any dividends in the future, and the timing and amount thereof, to our shareholders will fall within the discretion of our board of directors. The board’s decisions regarding the payment of dividends will depend on many factors, such as our financial condition, earnings, capital requirements, debt service obligations, restrictive covenants in our debt, industry practice, legal requirements, regulatory constraints and other factors that the board deems relevant. We cannot guarantee that we will pay a dividend in the future or continue to pay any dividends if we commence paying dividends.

### ***An individual shareholder’s percentage ownership in Keysight may be diluted in the future.***

In the future, the percentage ownership in Keysight may be diluted because of equity issuances for acquisitions, capital market transactions or otherwise, including equity awards that we will be granting to

our directors, officers and employees and purchases of our shares through our employee stock purchase plan. Our employees will have options to purchase shares of our common stock after the distribution as a result of conversion of their Agilent stock options to Keysight stock options. Our compensation committee has granted and will grant additional stock options or other stock-based awards to our employees and directors, from time to time, under our employee benefit plans. Such awards will have a dilutive effect on our earnings per share, which could adversely affect the market price of our common stock.

In addition, our amended and restated certificate of incorporation authorizes us to issue, without the approval of our shareholders, one or more classes or series of preferred stock having such designation, powers, preferences and relative, participating, optional and other special rights, including preferences over our common stock respecting dividends and distributions, as our board of directors generally may determine. The terms of one or more classes or series of preferred stock could dilute the voting power or reduce the value of our common stock. For example, we could grant the holders of preferred stock the right to elect some number of our directors in all events or on the happening of specified events or the right to veto specified transactions. Similarly, the repurchase or redemption rights or liquidation preferences that we could assign to holders of preferred stock could affect the residual value of the common stock.

***Certain provisions in our amended and restated certificate of incorporation and bylaws, and of Delaware law, may prevent or delay an acquisition of the company, which could decrease the trading price of our common stock.***

Our amended and restated certificate of incorporation and amended and restated bylaws contain, and Delaware law contains, provisions that are intended to deter coercive takeover practices and inadequate takeover bids by making such practices or bids unacceptably expensive to the bidder and to encourage prospective acquirers to negotiate with our board of directors rather than to attempt a hostile takeover. These provisions include, among others:

- the inability of our shareholders to call a special meeting;
- the inability of our shareholders to act without a meeting of shareholders;
- rules regarding how shareholders may present proposals or nominate directors for election at shareholder meetings;
- the right of our board to issue preferred stock without shareholder approval;
- the division of our board of directors into three classes of directors, with each class serving a staggered three-year term, and this classified board provision could have the effect of making the replacement of incumbent directors more time consuming and difficult;
- a provision that shareholders may only remove directors with cause;
- the ability of our directors, and not shareholders, to fill vacancies on our board of directors; and
- the requirement that the affirmative vote of shareholders holding at least 80% of our voting stock is required to amend certain provisions in our amended and restated certificate of incorporation (relating to the number, term and removal of our directors, the filling of our board vacancies, the advance notice to be given for nominations for elections of directors, the calling of special meetings of shareholders, shareholder action by written consent, the ability of the board of directors to amend the bylaws, elimination of liability of directors to the extent permitted by Delaware law, exclusive forum for certain types of actions and proceedings that may be initiated by our shareholders and amendments of the certificate of incorporation) and certain provisions in our amended and restated bylaws (relating to the calling of special meetings of shareholders, the business that may be conducted or considered at annual or special meetings, the advance notice of shareholder business and nominations, shareholder action by written consent, the number, tenure,

qualifications and removal of our directors, the filling of our board vacancies, director and officer indemnification and amendments of the bylaws).

In addition, because we have not chosen to be exempt from Section 203 of the Delaware General Corporation Law (the “DGCL”), this provision could also delay or prevent a change of control that some shareholders may favor. Section 203 provides that, subject to limited exceptions, persons that acquire, or are affiliated with a person that acquires, more than 15% of the outstanding voting stock of a Delaware corporation (an “interested stockholder”) shall not engage in any business combination with that corporation, including by merger, consolidation or acquisitions of additional shares, for a three-year period following the date on which the person became an interested stockholder, unless (i) prior to such time, the board of directors of such corporation approved either the business combination or the transaction that resulted in the stockholder becoming an interested stockholder; (ii) upon consummation of the transaction that resulted in the stockholder becoming an interested stockholder, the interested stockholder owned at least 85% of the voting stock of such corporation at the time the transaction commenced (excluding for purposes of determining the voting stock outstanding (but not the outstanding voting stock owned by the interested stockholder) the voting stock owned by directors who are also officers or held in employee benefit plans in which the employees do not have a confidential right to tender or vote stock held by the plan); or (iii) on or subsequent to such time the business combination is approved by the board of directors of such corporation and authorized at a meeting of shareholders by the affirmative vote of at least two-thirds of the outstanding voting stock of such corporation not owned by the interested stockholder.

We believe these provisions will protect our shareholders from coercive or otherwise unfair takeover tactics by requiring potential acquirers to negotiate with our board of directors and by providing our board of directors with more time to assess any acquisition proposal. These provisions are not intended to make us immune from takeovers. However, these provisions will apply even if the offer may be considered beneficial by some shareholders and could delay or prevent an acquisition that our board of directors determines is not in the best interests of the company and our shareholders. These provisions may also prevent or discourage attempts to remove and replace incumbent directors.

In addition, an acquisition or further issuance of our stock could trigger the application of Section 355(e) of the Code. Under the tax matters agreement, we would be required to indemnify Agilent for the resulting tax, and this indemnity obligation might discourage, delay or prevent a change of control that some shareholders may consider favorable.

***Our amended and restated certificate of incorporation designates that the state courts in the State of Delaware or, if no state court located within the State of Delaware has jurisdiction, the federal court for the District of Delaware, as the sole and exclusive forum for certain types of actions and proceedings that may be initiated by our shareholders, which could discourage lawsuits against the company and our directors and officers.***

Our amended and restated certificate of incorporation provide that unless the board of directors otherwise determines, the state courts in the State of Delaware or, if no state court located within the State of Delaware has jurisdiction, the federal court for the District of Delaware, will be the sole and exclusive forum for any derivative action or proceeding brought on our behalf, any action asserting a claim of breach of a fiduciary duty owed by any of our directors or officers to the company or our shareholders, any action asserting a claim against us or any of our directors or officers arising pursuant to any provision of the DGCL or Keysight’s amended and restated certificate of incorporation or bylaws, or any action asserting a claim against us or any of our directors or officers governed by the internal affairs doctrine. This exclusive forum provision may limit the ability of our shareholders to bring a claim in a judicial forum that such shareholders find favorable for disputes with us or our directors or officers, which may discourage such lawsuits against us and our directors and officers.

*If securities or industry analysts do not publish research or reports about our business, or publish negative reports about our business, our share price and trading volume could decline.*

The trading market for our common stock depends, to some extent, on the research and reports that securities or industry analysts publish about us and our business. We do not have any control over these analysts and the reports they issue. If our financial performance fails to meet analyst estimates or one or more of the analysts who cover us downgrade our shares or negatively change their opinion of our shares, our share price would likely decline. If one or more analysts cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which could cause our share price or trading volume to decline.

## CONTROLS AND PROCEDURES

### *Evaluation of Disclosure Controls and Procedures*

Our management has evaluated, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of October 31, 2014, pursuant to and as required by Rule 13a-15(b) under the Securities Exchange Act of 1934 (“Exchange Act”). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of October 31, 2014, the company’s disclosure controls and procedures, as defined by Rule 13a-15(e) under the Exchange Act, were effective and designed to ensure that (i) information required to be disclosed in the company’s reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and (ii) information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures.

### *Management’s Report on Internal Control over Financial Reporting*

This Annual Report on Form 10-K does not include a report of management’s assessment regarding internal control over financial reporting or an attestation report of the company’s registered public accounting firm due to a transition period established by rules of the SEC for newly public companies.

### *Changes in Internal Control Over Financial Reporting*

There were no changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

