UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended: October 31, 2004

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ______________ to ______________

Commission file number 1-4423

HEWLETT-PACKARD COMPANY

(Exact name of registrant as specified in its charter)

Delaware	**94-1081436**
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)
3000 Hanover Street, Palo Alto, California	**94304**
(Address of principal executive offices)	(Zip code)

Registrant's telephone number, including area code: **(650) 857-1501**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common stock, par value $0.01 per share	New York Stock Exchange, Inc. The Nasdaq Stock Market, Inc. The Pacific Exchange, Inc.

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by checkmark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes ☒ No ☐

The aggregate market value of the registrant's common stock held by non-affiliates was $59,850,144,000 based on the reported last sale price of common stock on April 30, 2004, which was the last business day of the registrant's most recently completed second fiscal quarter.

The number of shares of HP common stock outstanding as of December 31, 2004 was 2,910,039,823 shares.

DOCUMENTS INCORPORATED BY REFERENCE

DOCUMENT DESCRIPTION	10-K PART
Portions of the Registrant's notice of annual meeting of shareowners and proxy statement to be filed pursuant to Regulation 14A within 120 days after Registrant's fiscal year end of October 31, 2004 are incorporated by reference into Part II, Item 5 and Part III of this Report.	II, ITEM 5 III

ITEM 8. Financial Statements and Supplementary Data.

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Report of Independent Registered Public Accounting Firm

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

We have audited the accompanying consolidated balance sheets of Hewlett-Packard Company and subsidiaries as of October 31, 2004 and 2003, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended October 31, 2004. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Hewlett-Packard Company and subsidiaries at October 31, 2004 and 2003, and the consolidated results of their operations and their cash flows for each of the three years in the period ended October 31, 2004, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, on November 1, 2002 the Company changed its method of accounting for goodwill and intangible assets and in 2002 the Company changed its method of depreciation for assets placed in service after May 1, 2002.

/s/ ERNST & YOUNG LLP

San Jose, California
November 16, 2004

Statement of Management Responsibility

HP's management is responsible for the preparation, integrity and objectivity of the Consolidated Financial Statements and other financial information included in HP's 2004 Annual Report on Form 10-K. The Consolidated Financial Statements have been prepared in conformity with U.S. generally accepted accounting principles and reflect the effects of certain estimates and judgments made by management.

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

HP's Consolidated Financial Statements as of and for each of the three years in the period ended October 31, 2004 have been audited by Ernst & Young LLP, independent auditors. Their audits were conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States) and included a review of financial controls and tests of accounting records and procedures as they respectively considered necessary in the circumstances.

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

/s/ CARLETON S. FIORINA	/s/ ROBERT P. WAYMAN
Carleton S. Fiorina Chairman and Chief Executive Officer	Robert P. Wayman Executive Vice President and Chief Financial Officer

HEWLETT-PACKARD COMPANY AND SUBSIDIARIES

Consolidated Statements of Operations

	For the fiscal years ended October 31		
	2004	2003	2002
	In millions, except per share amounts		
Net revenue:			
Products	$64,127	$58,826	$45,878
Services	15,389	13,768	10,390
Financing income	389	467	320
Total net revenue	79,905	73,061	56,588
Costs and expenses:			
Cost of products	48,359	43,619	34,127
Cost of services	11,791	10,031	7,477
Financing interest	190	208	189
Research and development	3,506	3,651	3,368
Selling, general and administrative	11,024	11,012	8,763
Amortization of purchased intangible assets	603	563	402
Restructuring charges	114	800	1,780
Acquisition-related charges	54	280	701
In-process research and development charges	37	1	793
Total costs and expenses	75,678	70,165	57,600
Earnings (loss) from operations	4,227	2,896	(1,012)
Interest and other, net	35	21	52
Gains (losses) on investments and early extinguishment of debt	4	(29)	(75)
Dispute settlement	(70)	—	14
Earnings (loss) before taxes	4,196	2,888	(1,021)
Provision for (benefit from) taxes	699	349	(118)
Net earnings (loss)	$ 3,497	$ 2,539	$ (903)
Net earnings (loss) per share:			
Basic	$ 1.16	$ 0.83	$ (0.36)
Diluted	$ 1.15	$ 0.83	$ (0.36)
Weighted average shares used to compute net earnings (loss) per share:			
Basic	3,024	3,047	2,499
Diluted	3,055	3,063	2,499

The accompanying notes are an integral part of these Consolidated Financial Statements.

HEWLETT-PACKARD COMPANY AND SUBSIDIARIES

Consolidated Balance Sheets

	October 31 2004	October 31 2003
	In millions, except par value	
ASSETS		
Current assets:		
Cash and cash equivalents	$12,663	$14,188
Short-term investments	311	403
Accounts receivable	10,226	8,921
Financing receivables	2,945	3,026
Inventory	7,071	6,065
Other current assets	9,685	8,351
Total current assets	42,901	40,954
Property, plant and equipment	6,649	6,482
Long-term financing receivables and other assets	6,657	8,030
Goodwill	15,828	14,894
Purchased intangible assets	4,103	4,356
Total assets	$76,138	$74,716
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Notes payable and short-term borrowings	$ 2,511	$ 1,080
Accounts payable	9,377	9,285
Employee compensation and benefits	2,208	1,755
Taxes on earnings	1,709	1,599
Deferred revenue	2,958	2,496
Accrued restructuring	193	709
Other accrued liabilities	9,632	8,545
Total current liabilities	28,588	25,469
Long-term debt	4,623	6,494
Other liabilities	5,363	5,007
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.01 par value (300 shares authorized; none issued)	—	—
Common stock, $0.01 par value (9,600 shares authorized; 2,911 and 3,043 shares issued and outstanding, respectively)	29	30
Additional paid-in capital	22,129	24,587
Retained earnings	15,649	13,332
Accumulated other comprehensive loss	(243)	(203)
Total stockholders' equity	37,564	37,746
Total liabilities and stockholders' equity	$76,138	$74,716

The accompanying notes are an integral part of these Consolidated Financial Statements.

HEWLETT-PACKARD COMPANY AND SUBSIDIARIES

Consolidated Statements of Cash Flows

	For the fiscal years ended October 31		
	2004	2003	2002
		In millions	
Cash flows from operating activities:			
Net earnings (loss)	$ 3,497	$ 2,539	$ (903)
Adjustments to reconcile net earnings (loss) to net cash provided by operating activities:			
Depreciation and amortization	2,395	2,527	2,119
Provision for doubtful accounts—accounts and financing receivables	98	102	299
Provision for inventory	367	391	280
Restructuring charges	114	800	1,780
Acquisition-related charges, including in-process research and development	91	281	1,494
Deferred taxes on earnings	26	(279)	(351)
Other, net	89	141	234
Changes in assets and liabilities:			
Accounts and financing receivables	(696)	88	899
Inventory	(1,341)	(638)	844
Accounts payable	3	2,257	395
Taxes on earnings	(32)	53	(357)
Restructuring	(601)	(1,240)	(790)
Other assets and liabilities	1,078	(965)	(499)
Net cash provided by operating activities	5,088	6,057	5,444
Cash flows from investing activities:			
Investment in property, plant and equipment	(2,126)	(1,995)	(1,710)
Proceeds from sale of property, plant and equipment	447	353	362
Purchases of investments	(715)	(596)	(351)
Maturities and sales of investments	1,064	875	381
(Payments made) net cash acquired in connection with business acquisitions, net of acquisition costs	(1,124)	(149)	3,557
Dissolution of an equity investee	—	—	879
Net cash (used in) provided by investing activities	(2,454)	(1,512)	3,118
Cash flows from financing activities:			
Repayment of commercial paper and notes payable, net	(172)	(223)	(2,402)
Issuance of debt	9	749	2,529
Payment of long-term debt	(285)	(829)	(472)
Repurchase of zero-coupon subordinated convertible notes	—	—	(127)
Issuance of common stock under employee stock plans	570	482	377
Repurchase of common stock	(3,309)	(751)	(671)
Dividends	(972)	(977)	(801)
Net cash used in financing activities	(4,159)	(1,549)	(1,567)
(Decrease) increase in cash and cash equivalents	(1,525)	2,996	6,995
Cash and cash equivalents at beginning of period	14,188	11,192	4,197
Cash and cash equivalents at end of period	$12,663	$14,188	$11,192

The accompanying notes are an integral part of these Consolidated Financial Statements.

HEWLETT-PACKARD COMPANY AND SUBSIDIARIES

Consolidated Statements of Stockholders' Equity

	Common Stock		Additional		Accumulated Other	
	Number of Shares	Par Value	Paid-in Capital	Retained Earnings	Comprehensive Income (Loss)	Total
	In millions, except number of shares in thousands					
Balance October 31, 2001	1,938,828	$19	$ 200	$13,693	$ 41	$13,953
Net loss				(903)		(903)
Net unrealized loss on available-for-sale securities					(9)	(9)
Net unrealized loss on cash flow hedges					(61)	(61)
Minimum pension liability, net of taxes					(379)	(379)
Cumulative translation adjustment					7	7
Comprehensive loss						(1,345)
Issuance of common stock and options assumed in connection with business acquisitions	1,114,673	11	24,706			24,717
Issuance of common stock in connection with employee stock plans and other	29,855		388			388
Repurchases of common stock	(39,623)		(655)	(16)		(671)
Tax benefit from employee stock plans			21			21
Dividends				(801)		(801)
Balance October 31, 2002	3,043,733	30	24,660	11,973	(401)	36,262
Net earnings				2,539		2,539
Net unrealized gain on available-for-sale securities					33	33
Net unrealized loss on cash flow hedges					(48)	(48)
Minimum pension liability, net of taxes					211	211
Cumulative translation adjustment					2	2
Comprehensive income						2,737
Issuance of common stock in connection with employee stock plans and other	38,808		451			451
Repurchases of common stock	(39,780)		(548)	(203)		(751)
Tax benefit from employee stock plans			24			24
Dividends				(977)		(977)
Balance October 31, 2003	3,042,761	30	24,587	13,332	(203)	37,746
Net earnings				3,497		3,497
Net unrealized loss on available-for-sale securities					(20)	(20)
Net unrealized loss on cash flow hedges					(28)	(28)
Minimum pension liability, net of taxes					(13)	(13)
Cumulative translation adjustment					21	21
Comprehensive income						3,457
Assumption of stock options in connection with business acquisitions			15			15
Issuance of common stock in connection with employee stock plans and other	40,467		592			592
Repurchases of common stock	(172,468)	(1)	(3,100)	(208)		(3,309)
Tax benefit from employee stock plans			35			35
Dividends				(972)		(972)
Balance October 31, 2004	2,910,760	$29	$22,129	$15,649	$(243)	$37,564

The accompanying notes are an integral part of these Consolidated Financial Statements.

Note 1: Summary of Significant Accounting Policies

Principles of Consolidation

The Consolidated Financial Statements include the accounts of Hewlett-Packard Company, its wholly-owned subsidiaries and its controlled majority-owned subsidiaries (collectively, "HP"). Equity investments in companies over which HP has the ability to exercise significant influence, but does not hold a controlling interest, are accounted for under the equity method, and HP's proportionate share of income or losses is recorded in Interest and other, net in the Consolidated Statements of Operations. All significant intercompany accounts and transactions have been eliminated.

Reclassifications and Segment Reorganization

Certain reclassifications have been made to prior year amounts or balances in order to conform to the current year presentation. The long-term portion of deferred revenue previously classified as current deferred revenue has been reclassified to Other liabilities, and the prior year presentation also has been reclassified for comparative purposes. This reclassification did not impact HP's consolidated net revenue and also had no impact on HP's Consolidated Statements of Operations, Consolidated Statements of Cash Flows or Consolidated Statements of Stockholders' Equity for all periods presented. As further described in Note 18, at the beginning of the first quarter of fiscal 2004 HP's business segments were realigned. Prior period segment operating results have been restated for all periods presented to reflect the new organizational structure.

Use of Estimates

The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in HP's Consolidated Financial Statements and accompanying notes. Actual results could differ materially from those estimates.

Revenue Recognition

HP recognizes revenue when persuasive evidence of a sales arrangement exists, delivery occurs or services are rendered, the sales price or fee is fixed or determinable and collectibility is reasonably assured. When a sales arrangement contains multiple elements, such as hardware and software products, licenses and/or services, HP allocates revenue to each element based on its relative fair value. Fair value for software is determined based on vendor specific objective evidence ("VSOE") or, in the absence of VSOE for all the elements, the residual method when VSOE exists for all the undelivered elements. The price charged when the software is sold separately determines VSOE. In the absence of fair value for a delivered element, HP first allocates revenue to the fair value of the undelivered elements and the residual revenue to the delivered elements. Where the fair value for an undelivered element cannot be determined, HP defers revenue for the delivered elements until the undelivered elements are delivered. HP limits the amount of revenue recognition for delivered elements to the amount that is not contingent on the future delivery of products or services or subject to customer-specified return or refund privileges.

HP ceases revenue recognition on delinquent accounts based upon a number of factors, including customer credit history, number of days past due and the terms of the customer agreement. HP

Note 1: Summary of Significant Accounting Policies (Continued)

resumes revenue recognition and recognizes any associated deferred revenue when appropriate customer actions are taken to remove accounts from delinquent status.

Products

Under HP's standard terms and conditions of sale, HP transfers title and risk of loss to the customer at the time product is delivered to the customer and revenue is recognized accordingly, unless customer acceptance is uncertain or significant obligations remain. HP reduces revenue for estimated customer returns, price protection, rebates and other offerings that occur under sales programs established by HP directly or with HP's distributors and resellers. HP recognizes revenue allocated to software licenses at the inception of the license. Revenue from the sale of equipment under sales-type leases and direct-financing leases is recorded as product revenue at the inception of the lease. HP accrues the estimated cost of post-sale obligations, including basic product warranties, based on historical experience at the time HP recognizes revenue.

Services

HP recognizes revenue from fixed-price support or maintenance contracts, including extended warranty contracts and software post-contract support contracts, ratably over the contract period and recognizes the costs associated with these contracts as incurred. For time and material contracts, HP recognizes revenue and costs as services are rendered. Revenue from fixed-price consulting arrangements is recognized over the contract period on a proportional performance basis, as determined by the relationship of actual costs incurred to date to the estimated total contract costs, with estimates regularly revised during the life of the contact. For outsourcing contracts, HP recognizes revenue ratably over the contractual service period for fixed price contracts and on the output or consumption basis for all other outsourcing contracts. HP recognizes costs associated with outsourcing contracts as incurred, unless such costs relate to the transition phase of the outsourcing contract, in which case HP generally amortizes those costs over the contractual service period. Losses on consulting and outsourcing arrangements are recognized in the period that the contractual loss becomes probable and estimable. HP records amounts invoiced to customers in excess of revenue recognized as deferred revenue until the revenue recognition criteria are met. HP records revenue that is earned and recognized in excess of amounts invoiced on fixed-price contracts as trade receivables. HP recognizes revenue from operating leases on an accrual basis as services revenue when the rental payments become due.

Financing Income

Financing income is produced by sales-type and direct-financing leases and is recognized on the accrual basis under the effective interest method. Certain financing receivables for which HP recorded specific reserves are placed on nonaccrual status. Nonaccrual assets are those receivables with specific reserves and other delinquent accounts for which it is likely that HP will be unable to collect all amounts due according to the terms of the customer agreement. Income recognition is discontinued on these receivables. Financing receivables are removed from nonaccrual status when appropriate customer actions are taken to remove the accounts from delinquent status.

Note 1: Summary of Significant Accounting Policies (Continued)

Shipping and Handling

Costs related to shipping and handling are included in cost of sales for all periods presented.

Advertising

Advertising costs are expensed as incurred or when the advertising is first run and totaled approximately $1.8 billion in each of fiscal 2004 and 2003 and $1.4 billion in fiscal 2002.

Taxes on Earnings

HP recognizes deferred tax assets and liabilities for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts using enacted tax rates in effect for the year the differences are expected to reverse. HP records a valuation allowance to reduce the deferred tax assets to the amount that is more likely than not to be realized.

Cash and Cash Equivalents

HP classifies investments as cash equivalents if the maturity of an investment is three months or less from the purchase date. Interest income was approximately $238 million in fiscal 2004, $240 million in fiscal 2003 and $241 million in fiscal 2002.

Allowance for Doubtful Accounts

HP establishes an allowance for doubtful accounts to ensure trade and financing receivables are not overstated due to uncollectibility. Bad debt reserves are maintained based on a variety of factors, including the length of time receivables are past due, trends in overall weighted average risk rating of the total portfolio, macroeconomic conditions, significant one-time events, historical experience and the use of third-party credit risk models that generate quantitative measures of default probabilities based on market factors and the financial condition of customers. A specific reserve for individual accounts is recorded when HP becomes aware of a customer's inability to meet its financial obligations, such as in the case of bankruptcy filings or deterioration in the customer's operating results or financial position. If circumstances related to customers change, estimates of the recoverability of receivables would be further adjusted.

Inventory

Inventory is valued at the lower of cost or market, with cost computed on a first-in, first-out basis.

Property, Plant and Equipment

Property, plant and equipment is stated at cost less accumulated depreciation. Additions, improvements and major renewals are capitalized. Maintenance, repairs and minor renewals are expensed as incurred. Depreciation is provided using straight-line or accelerated methods over the estimated useful lives of the assets. Estimated useful lives are 5 to 40 years for buildings and improvements and 3 to 10 years for machinery and equipment. Leasehold improvements are depreciated over the life of the lease or the asset, whichever is shorter. Equipment held for lease is depreciated over the initial term of the lease to the equipment's estimated residual value.

Note 1: Summary of Significant Accounting Policies (Continued)

HP uses the straight-line method of depreciation for all property, plant and equipment placed into service after April 30, 2002. Property, plant and equipment placed into service prior to May 1, 2002 is depreciated using accelerated methods for buildings, improvements and the majority of machinery and equipment. The effect of this change was not material to HP's earnings or financial position for the fiscal year ended October 31, 2002.

Goodwill and Indefinite-Lived Purchased Intangible Assets

Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets," which was effective for HP for fiscal 2003, prohibits the amortization of goodwill and purchased intangible assets with indefinite useful lives. HP reviews goodwill and purchased intangible assets with indefinite lives for impairment annually at the beginning of its fourth fiscal quarter and whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable in accordance with SFAS No. 142. HP performs a two-step impairment test. In the first step, HP compares the fair value of each reporting unit to its carrying value. HP determines the fair value of its reporting units based on a weighting of income and market approaches. Under the income approach, HP calculates the fair value of a reporting unit based on the present value of estimated future cash flows. Under the market approach, HP estimates the fair value based on market multiples of revenue or earnings for comparable companies. If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, goodwill is not impaired and no further testing is performed. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, then HP must perform the second step impairment test in order to determine the implied fair value of the reporting unit's goodwill. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, HP records an impairment loss equal to the difference. SFAS No. 142 also requires that the fair value of the indefinite-lived purchased intangible assets be estimated and compared to the carrying value. HP estimates the fair value of these intangible assets using an income approach. HP recognizes an impairment loss when the estimated fair value of the indefinite-lived purchased intangible assets is less than the carrying value.

Long-Lived Assets Including Finite-Lived Purchased Intangible Assets

Purchased intangible assets with finite lives are amortized using the straight-line method over the estimated economic lives of the assets, ranging from one to ten years.

Long-lived assets, such as property, plant and equipment and purchased intangible assets with finite lives, are evaluated for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." HP assesses the fair value of the assets based on the undiscounted future cash flow the assets are expected to generate and recognizes an impairment loss when estimated undiscounted future cash flow expected to result from the use of the asset plus net proceeds expected from disposition of the asset, if any, are less than the carrying value of the asset. When an impairment is identified, HP reduces the carrying amount of the asset to its estimated fair value based on a discounted cash flow approach or, when available and appropriate, to comparable market values.

Note 1: Summary of Significant Accounting Policies (Continued)

Capitalized Software

HP capitalizes certain internal and external costs incurred to acquire or create internal use software, principally related to software coding, designing system interfaces, and installation and testing of the software. Capitalized costs are amortized over the estimated useful lives of the software, generally from one to three years.

Derivative Financial Instruments

HP uses derivative financial instruments, including forwards, swaps, and options, to hedge certain foreign currency and interest rate exposures. Other derivatives not designated as hedges may also be used by HP, primarily forwards used to hedge foreign currency balance sheet exposures and warrants in companies invested in as part of strategic relationships. HP does not use derivative financial instruments for speculative purposes. See Note 8 for a full description of HP's derivative financial instrument activities and related accounting policies.

Investments

HP's investments consist principally of time deposits, repurchase agreements, municipal securities, other debt securities and equity securities of publicly-held and privately-held companies. Investments with maturities of less than one year are classified as short-term investments.

HP's investments in debt securities and its equity investments in public companies are classified as available-for-sale securities and carried at fair value. Fair values for investments in public companies are determined using quoted market prices. The unrealized gains and losses on available-for-sale securities, net of taxes, are recorded in accumulated other comprehensive loss.

Equity investments in privately-held companies are carried at the lower of cost or fair value. Fair values for investments in privately-held companies may be estimated based upon one or more of the following: pricing models using historical and forecasted financial information and current market rates; liquidation values; the values of recent rounds of financing; and quoted market prices of comparable public companies.

Losses on Investments

HP monitors its investment portfolio for impairment on a periodic basis. In the event that the carrying value of an investment exceeds its fair value and the decline in value is determined to be other-than-temporary, an impairment charge is recorded and a new cost basis for the investment is established. In order to determine whether a decline in value is other-than-temporary, HP evaluates, among other factors: the duration and extent to which the fair value has been less than the carrying value; the financial condition of and business outlook for the company, including key operational and cash flow metrics, current market conditions and future trends in the company's industry; the company's relative competitive position within the industry; and HP's intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in fair value.

The declines in value of certain investments were determined to be other-than-temporary. Accordingly, HP recorded impairments of approximately $26 million in fiscal 2004, $72 million in fiscal 2003 and $106 million in fiscal 2002. These impairments are included in Gains (losses) on investments

Note 1: Summary of Significant Accounting Policies (Continued)

and early extinguishment of debt in the Consolidated Statements of Operations. Depending on market conditions, HP may record additional impairments on its investment portfolio in the future.

Concentrations of Credit Risk

Financial instruments that potentially subject HP to significant concentrations of credit risk consist principally of cash, investments, accounts receivable, financing receivables and derivatives.

HP maintains cash and cash equivalents, short and long-term investments, derivatives and certain other financial instruments with various financial institutions. These financial institutions are located in many different geographical regions, and HP's policy is designed to limit exposure with any one institution. As part of its cash and risk management processes, HP performs periodic evaluations of the relative credit standing of the financial institutions. HP has not sustained material credit losses from instruments held at financial institutions. HP utilizes forward contracts and other derivative contracts to protect against the effects of foreign currency fluctuations. Such contracts involve the risk of non-performance by the counterparty, which could result in a material loss.

HP sells a significant portion of its products through third-party distributors and resellers and, as a result, maintains individually significant receivable balances with these parties. If the financial condition or operations of these distributors and resellers deteriorate substantially, HP's operating results could be adversely affected. The ten largest distributor and reseller receivable balances collectively, which were concentrated primarily in North America, represented approximately 23% of gross accounts receivable at October 31, 2004 and 21% at October 31, 2003. No single customer accounts for more than 10% of accounts receivable. Credit risk with respect to other accounts receivable and financing receivables is generally diversified due to the large number of entities comprising HP's customer base and their dispersion across many different industries and geographical regions. HP performs ongoing credit evaluations of the financial condition of its third-party distributors, resellers and other customers and requires collateral, such as letters of credit and bank guarantees, in certain circumstances. HP generally has experienced longer accounts receivable collection cycles in its emerging markets, in particular Asia Pacific and Latin America, when compared to its United States and European markets. In the event that accounts receivable collection cycles in the emerging markets significantly deteriorate or one or more of HP's larger resellers in these regions fail, HP's operating results could be adversely affected.

Stock-Based Compensation

HP applies the intrinsic-value-based method prescribed in Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," in accounting for employee stock-based compensation. Accordingly, HP generally recognizes compensation expense only when it grants options with a discounted exercise price. HP recognizes any resulting compensation expense ratably over the associated service period, which is generally the option vesting term.

HP has determined pro forma amounts as if the fair value method required by SFAS No. 123, "Accounting for Stock-Based Compensation," had been applied to its stock-based compensation. See Note 13 for descriptions of HP's stock-based compensation plans. The fair value of stock options and stock purchase rights were estimated on the date of grant using the Black-Scholes option pricing model.

Note 1: Summary of Significant Accounting Policies (Continued)

The weighted average fair values and the assumptions used in calculating such values during each fiscal year were as follows:

	Stock Options			Stock Purchase Rights		
	2004	2003	2002	2004	2003	2002
Weighted average fair value of grants	$6.72	$5.15	$8.64	$4.95	$5.92	$5.81
Risk-free interest rate	2.77%	3.23%	4.84%	1.11%	1.21%	1.94%
Dividend yield	1.4%	1.8%	1.8%	1.5%	1.9%	1.9%
Expected volatility	35%	35%	39%	28%	47%	54%
Expected life in months	60	72	84	6	6	6

The pro forma effect on net earnings (loss) as if the fair value of stock-based compensation had been recognized as compensation expense on a straight-line basis over the vesting period of the stock option or purchase right was as follows for the fiscal years ended October 31:

	2004	2003	2002
	In millions, except per share amounts		
Net earnings (loss), as reported	$3,497	$2,539	$ (903)
Add: Stock-based compensation included in reported net earnings (loss), net of related tax effects	33	30	85
Less: stock-based compensation expense determined under the fair-value based method for all awards, net of related tax effects	(751)	(844)	(860)
Pro forma net earnings (loss)	$2,779	$1,725	$(1,678)
Basic net earnings (loss) per share:			
As reported	$ 1.16	$ 0.83	$ (0.36)
Pro forma	$ 0.92	$ 0.57	$ (0.67)
Diluted net earnings (loss) per share:			
As reported	$ 1.15	$ 0.83	$ (0.36)
Pro forma	$ 0.91	$ 0.56	$ (0.67)

Foreign Currency Transactions

HP uses the U.S. dollar predominately as its functional currency. Assets and liabilities denominated in non-U.S. dollars are remeasured into U.S. dollars at end-of-period exchange rates, except for inventory, property, plant and equipment, other assets and deferred revenue, which are remeasured at historical exchange rates. Net revenue, cost of sales and expenses are remeasured at average exchange rates in effect during each period, except for those net revenue, cost of sales and expenses related to the previously noted balance sheet amounts, which are remeasured at historical exchange rates. Gains or losses from foreign currency remeasurement are included in net earnings (loss). Certain foreign subsidiaries designate the local currency as their functional currency and the translation of their assets and liabilities into U.S. dollars at the balance sheet dates are recorded as

Note 1: Summary of Significant Accounting Policies (Continued)

translation adjustments and included as a component of accumulated other comprehensive income (loss).

Retirement and Post-Retirement Plans

HP has various defined benefit, defined contribution and other contributory and noncontributory retirement and post-retirement plans. HP amortizes unrecognized actuarial gains and losses on a straight-line basis over the remaining estimated service life of participants. The measurement date for all plans is September 30 for fiscal 2004 and fiscal 2003. During fiscal 2002, the measurement dates were October 31 for HP plans and September 30 for Compaq plans. See Note 15 for a full description of these plans and the accounting and funding policies.

Recent Pronouncements

FASB Staff Position ("FSP") No. 109-2, "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004" ("FSP 109-2"), provides guidance under FASB Statement No. 109, "Accounting for Income Taxes," with respect to recording the potential impact of the repatriation provisions of the American Jobs Creation Act of 2004 (the "Jobs Act") on enterprises' income tax expense and deferred tax liability. The Jobs Act was enacted on October 22, 2004. FSP 109-2 states that an enterprise is allowed time beyond the financial reporting period of enactment to evaluate the effect of the Jobs Act on its plan for reinvestment or repatriation of foreign earnings for purposes of applying FASB Statement No. 109. HP has not yet completed evaluating the impact of the repatriation provisions. Accordingly, as provided for in FSP 109-2, HP has not adjusted its tax expense or deferred tax liability to reflect the repatriation provisions of the Jobs Act.

In May 2004, the FASB issued FSP No. 106-2 ("FSP 106-2"), "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" (the "Medicare Act"). The Medicare Act was enacted December 8, 2003. FSP 106-2 supersedes FSP 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003," and provides authoritative guidance on accounting for the federal subsidy specified in the Medicare Act. The Medicare Act provides for a federal subsidy equal to 28% of certain prescription drug claims for sponsors of retiree health care plans with drug benefits that are at least actuarially equivalent to those to be offered under Medicare Part D, beginning in 2006. HP has concluded that the prescription drug benefits provided under its plans are at least actuarially equivalent to the prescription drug benefits offered under Medicare Part D.

FSP 106-2 provides that: (1) the effect of the federal subsidy should be accounted for as an actuarial experience gain; (2) since the federal subsidy is exempt from federal taxes, any plan-related temporary income tax difference should exclude the effect of the subsidy; and (3) the effective date of FSP 106-2 is the first interim or annual period beginning after June 15, 2004, with early adoption encouraged.

In the third quarter of fiscal 2004, HP adopted FSP 106-2 retroactive to December 2003, the date of the enactment of the Medicare Act. As the annual measurement date for HP's U.S. postretirement benefit plans is September 30, HP's 2004 fiscal year expense is impacted by approximately 10 months. The expected subsidy reduced HP's accumulated postretirement benefit obligation by approximately

Note 1: Summary of Significant Accounting Policies (Continued)

$133 million, which HP recognized as a reduction in the unrecognized net actuarial loss. HP amortizes the unrecognized net actuarial loss over the average remaining service life of HP's employees eligible for postretirement benefits. The adoption of FSP 106-2 also affects service and interest costs associated with the plans and reduced the net periodic postretirement cost by approximately $10 million in fiscal 2004. The expense amounts shown in Note 15 reflect the effects of the early adoption of FSP 106-2. HP may adjust these amounts in the future, as detailed regulations necessary to implement the Medicare Act have not been issued.

The adoption of the following recent accounting pronouncements did not have a material impact on HP's results of operations and financial condition:

- FASB Interpretation No. 45 ("FIN 45"), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others—An Interpretation of FASB Statements No. 5, 57, and 107 and Rescission of FASB Interpretation No. 34";
- FASB Interpretation No. 46(R) ("FIN 46R"), "Consolidation of Variable Interest Entities—An Interpretation of ARB No. 51";
- FASB issued revised SFAS No. 132 (R) (revised 2003), "Employer's Disclosures about Pensions and Other Post-Retirement Benefits—An Amendment of FASB Statements No. 87, 88, and 106";
- EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments"; and
- EITF Issue No. 03-5, "Applicability of AICPA Statement of Position 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software."

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs—An Amendment of ARB No. 43, Chapter 4" ("SFAS 151"). SFAS 151 amends the guidance in ARB No. 43, Chapter 4, "Inventory Pricing," to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Among other provisions, the new rule requires that items such as idle facility expense, excessive spoilage, double freight, and rehandling costs be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal" as stated in ARB No. 43. Additionally, SFAS 151 requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS 151 is effective for fiscal years beginning after June 15, 2005 and is required to be adopted by HP in the first quarter of fiscal 2006, beginning on November 1, 2005. HP is currently evaluating the effect that the adoption of SFAS 151 will have on its consolidated results of operations and financial condition but does not expect SFAS 151 to have a material impact.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"), which replaces SFAS No. 123, "Accounting for Stock-Based Compensation," ("SFAS 123") and supercedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values beginning with the first interim or annual period after June 15, 2005, with early adoption encouraged. The pro forma disclosures previously permitted under SFAS 123 no longer will be an alternative to financial statement recognition. HP is required to adopt SFAS 123R in the fourth quarter of fiscal 2005, beginning August 1, 2005. Under SFAS 123R, HP must

Note 1: Summary of Significant Accounting Policies (Continued)

determine the appropriate fair value model to be used for valuing share-based payments, the amortization method for compensation cost and the transition method to be used at date of adoption. The transition methods include prospective and retroactive adoption options. Under the retroactive option, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. The prospective method requires that compensation expense be recorded for all unvested stock options and restricted stock at the beginning of the first quarter of adoption of SFAS 123R, while the retroactive methods would record compensation expense for all unvested stock options and restricted stock beginning with the first period restated. HP is evaluating the requirements of SFAS 123R and expects that the adoption of SFAS 123R will have a material impact on HP's consolidated results of operations and earnings per share. HP has not yet determined the method of adoption or the effect of adopting SFAS 123R, and it has not determined whether the adoption will result in amounts that are similar to the current pro forma disclosures under SFAS 123.

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets—An Amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions" ("SFAS 153"). SFAS 153 eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in paragraph 21(b) of APB Opinion No. 29, "Accounting for Nonmonetary Transactions," and replaces it with an exception for exchanges that do not have commercial substance. SFAS 153 specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS 153 is effective for the fiscal periods beginning after June 15, 2005 and is required to be adopted by HP in the first quarter of fiscal 2006, beginning on November 1, 2005. HP is currently evaluating the effect that the adoption of SFAS 153 will have on its consolidated results of operations and financial condition but does not expect it to have a material impact.

Note 2: Net Earnings (Loss) Per Share ("EPS")

HP's basic EPS is calculated using net earnings (loss) and the weighted-average number of shares outstanding during the reporting period. Diluted EPS includes the effect from potential issuance of common stock, such as stock issuable pursuant to the exercise of stock options and the assumed conversion of convertible notes.

Note 2: Net Earnings (Loss) Per Share ("EPS") (Continued)

The reconciliation of the numerators and denominators of the basic and diluted EPS calculations was as follows for the fiscal years ended October 31:

	2004	2003	2002
	In millions, except per share amounts		
Numerator:			
Net earnings (loss)	$3,497	$2,539	$ (903)
Adjustment for interest expense on zero-coupon subordinated convertible notes, net of taxes	8	—	—
Net earnings (loss), adjusted	$3,505	$2,539	$ (903)
Denominator:			
Weighted-average shares used to compute basic EPS	3,024	3,047	2,499
Effect of dilutive securities:			
Dilution from employee stock plans	23	16	—
Zero-coupon subordinated convertible notes	8	—	—
Dilutive potential common shares	31	16	—
Weighted-average shares used to compute diluted EPS	3,055	3,063	2,499
Net earnings (loss) per share:			
Basic	$ 1.16	$ 0.83	$(0.36)
Diluted	$ 1.15	$ 0.83	$(0.36)

In fiscal 2004, 2003 and 2002, options to purchase approximately 408 million, 362 million and 459 million, respectively, of HP stock were excluded from the calculation of diluted EPS because the effect was antidilutive. Stock options are antidilutive when the exercise price of the options is greater than the average market price of the common shares for the period or when the results from operations are a net loss. In addition, the assumed conversion of zero-coupon subordinated notes into approximately 8 million shares of HP stock was excluded from the calculation of diluted EPS in fiscal 2003 and 2002 because the effect was antidilutive.

Note 3: Balance Sheet Details

Balance sheet details were as follows at October 31:

Accounts and Financing Receivables

	2004	2003
	In millions	
Accounts receivable	$10,512	$9,268
Allowance for doubtful accounts	(286)	(347)
	$10,226	$8,921
Financing receivables	$ 3,066	$3,145
Allowance for doubtful accounts	(121)	(119)
	$ 2,945	$3,026

HP entered into a six-year revolving agreement during the third quarter of fiscal 2004 to sell certain trade receivables without recourse. Sold receivables are collected by the third party, with the sales of receivables limited only by the outstanding maximum balance of receivables not yet collected by the third party. Trade receivables of approximately 680 million euros were sold during the last half of fiscal 2004, primarily during the fourth quarter. The implementation of this program did not have a material impact on HP's outstanding receivable balance as utilization of this program was limited to certain customer receivables that were already under an alternative prompt payment program. Fees associated with this program do not differ materially from the cash discounts offered to these customers under the alternative prompt payment program.

Inventory

	2004	2003
	In millions	
Finished goods	$5,322	$4,653
Purchased parts and fabricated assemblies	1,749	1,412
	$7,071	$6,065

Other Current Assets

	2004	2003
	In millions	
Deferred tax assets—short term	$3,744	$2,938
Other receivables	4,839	4,206
Other current assets	1,102	1,207
	$9,685	$8,351

Note 3: Balance Sheet Details (Continued)

Property, Plant and Equipment

	2004	2003
	In millions	
Land	$ 657	$ 810
Buildings and leasehold improvements	5,752	4,959
Machinery and equipment	7,427	7,530
	13,836	13,299
Accumulated depreciation	(7,187)	(6,817)
	$ 6,649	$ 6,482

Depreciation expense was approximately $1.8 billion in fiscal 2004, $2.0 billion in fiscal 2003 and $1.7 billion in fiscal 2002.

Long-Term Financing Receivables and Other Assets

	2004	2003
	In millions	
Financing receivables	$2,168	$2,745
Deferred tax assets—long term	2,111	2,859
Other	2,378	2,426
	$6,657	$8,030

Other Accrued Liabilities

	2004	2003
	In millions	
Other accrued taxes	$2,157	$1,756
Warranty	1,494	1,413
Other	5,981	5,376
	$9,632	$8,545

Other Liabilities

	2004	2003
	In millions	
Pension, post-retirement, and post-employment liabilities	$2,620	$2,596
Long-term deferred revenue	1,390	1,169
Other long-term liabilities	1,353	1,242
	$5,363	$5,007

Note 4: Supplemental Cash Flow Information

Supplemental cash flow information was as follows for the fiscal years ended October 31:

	2004	2003	2002
		In millions	
Cash paid for income taxes, net	$ 609	$ 464	$ 139
Cash paid for interest	$ 305	$ 394	$ 206
Non-cash investing and financing activities:			
Net issuances of restricted stock and other employee stock benefits	$ 68	$ 3	$ 11
Issuance of common stock and options assumed in business acquisitions	$ 15	$ —	$24,717

Note 5: Acquisitions

Acquisitions have been recorded using the purchase method of accounting, and, accordingly, the results of operations are included in HP's consolidated results as of the date of each acquisition. HP allocates the purchase price of its acquisitions to the tangible assets, liabilities and intangible assets acquired, including in-process research and development ("IPR&D"), based on their estimated fair values. The excess purchase price over those fair values is recorded as goodwill. The fair value assigned to assets acquired is based on valuations using management's estimates and assumptions. The goodwill recorded as a result of these acquisitions is not expected to be deductible for tax purposes.

Compaq

On May 3, 2002, HP acquired all of the outstanding stock of Compaq Computer Corporation ("Compaq"), a leading global provider of information technology products, services and solutions, in exchange for 0.6325 shares of HP common stock for each outstanding share of Compaq common stock and the assumption of options to purchase Compaq common stock based on the same ratio. In addition, HP assumed certain Compaq stock plans. The acquisition of Compaq has enhanced HP's competitive position in key industries, while strengthening its sales force and relationships with strategic customer bases. The acquisition has enabled HP to focus on strategic product and customer bases, achieve significant cost synergies and economies of scale and improve the results of its Enterprise Storage and Servers ("ESS") and Software businesses (formerly combined as the Enterprise Systems Group), Personal Systems Group ("PSG") and HP Services ("HPS") businesses. Furthermore, these cost savings offer strategic benefits by reducing HP's cost structure in competitive businesses such as personal computers ("PCs"). The acquisition also has allowed the Imaging and Printing Group ("IPG") to leverage the interrelationship between PC and printer sales and utilize Compaq's direct distribution capabilities. HP derived the exchange ratio in the acquisition from estimates of future revenue and earnings of the combined company assuming completion of the acquisition, and from measuring the relative contributions of each of HP and Compaq to achieving these forecasted results, in addition to measuring the relative ownership of the combined company implied by their contributions. This transaction resulted in the issuance of approximately 1.1 billion shares of HP common stock with a fair value of approximately $22.7 billion, the assumption of Compaq options to purchase approximately 200 million shares of HP common stock with a Black-Scholes fair value of approximately $1.4 billion and estimated direct transaction costs of $79 million, for a total purchase price of $24.2 billion. The fair value of HP common stock was derived using an average market price per share of HP common stock of $20.92, which was based on an average of the closing prices for a range of trading days around September 3, 2001, the announcement date of the acquisition.

Note 5: Acquisitions (Continued)

Of the total purchase price for this acquisition, $14.5 billion was allocated to goodwill, $3.5 billion was allocated to amortizable purchased intangible assets and $1.4 billion was allocated to intangible assets with an indefinite life. The purchase price also included $18.4 billion of additional assets and $14.3 billion of assumed liabilities. HP is amortizing the purchased intangibles on a straight-line basis over weighted average estimated useful lives of approximately 9 years for customer contracts and approximately 6 years for developed and core technology and patents. The intangible asset with an indefinite life is the Compaq trade name. This intangible asset will not be amortized because it has an indefinite remaining useful life based on many factors and considerations, including the length of time that the Compaq name has been in use, the Compaq brand awareness and market position and the plans for continued use of the Compaq brand within a portion of HP's overall product portfolio.

Of the total purchase price, $735 million was allocated to IPR&D and was expensed in the third quarter of fiscal 2002. Projects that qualify as IPR&D represent those that have not yet reached technological feasibility and for which no future alternative uses exist. Technological feasibility is defined as being equivalent to a beta-phase working prototype in which there is no remaining risk relating to the development.

The value assigned to IPR&D was determined by considering the importance of each project to the overall development plan, estimating costs to develop the purchased IPR&D into commercially viable products, estimating the resulting net cash flows from the projects when completed and discounting the net cash flows to their present value. The revenue estimates used to value the purchased IPR&D were based on estimates of the relevant market sizes and growth factors, expected trends in technology and the nature and expected timing of new product introductions by Compaq and its competitors.

The rates utilized to discount the net cash flows to their present values were based on Compaq's weighted average cost of capital. The weighted average cost of capital was adjusted to reflect the difficulties and uncertainties in completing each project and thereby achieving technological feasibility, the percentage-of-completion of each project, anticipated market acceptance and penetration, market growth rates and risks related to the impact of potential changes in future target markets. Based on these factors, discount rates that range from 25% - 42% were deemed appropriate for valuing the IPR&D.

In accordance with the terms of Compaq's equity-based plans, all of Compaq's outstanding options that were granted prior to September 1, 2001 vested upon Compaq stockholder approval of the acquisition. The intrinsic value of unvested Compaq options of approximately $70 million as of May 3, 2002, which relates to options granted subsequent to August 31, 2001, was allocated to deferred compensation in the purchase price allocation. HP amortizes the deferred compensation over the remaining vesting period of the options, which was approximately 3.5 years at May 3, 2002.

Pro forma results

The following unaudited pro forma financial information presents the combined results of operations of HP and Compaq as if the acquisition had occurred as of the beginning of the period presented. Due to different historical fiscal period ends for HP and Compaq, the results for the year ended October 31, 2002 combine the historical results of HP for the year ended October 31, 2002 and the historical quarterly results of Compaq for the six months ended March 31, 2002 and for the period from May 3, 2002 (the acquisition date) to October 31, 2002. An adjustment of $162 million was made

Note 5: Acquisitions (Continued)

to the combined results of operations, reflecting amortization of purchased intangible assets, net of tax, that would have been recorded if the acquisition had occurred at the beginning of the period presented. The unaudited pro forma financial information is not intended to represent or be indicative of the consolidated results of operations or financial condition of HP that would have been reported had the acquisition been completed as of the beginning of the period presented, and should not be taken as representative of the future consolidated results of operations or financial condition of HP. Pro forma results were as follows for the fiscal year ended October 31, 2002:

	In millions, except per share amounts
Net revenue	$72,346
Cost of sales[1]	54,311
Gross margin	18,035
Research and development	3,953
Selling, general and administrative	11,091
Amortization of purchased intangible assets and goodwill	664
Restructuring charges	1,780
Acquisition-related charges	772
In-process research and development charges	793
Loss from operations	(1,018)
Interest and other, net	20
Losses on investments and early extinguishment of debt	(70)
Dispute settlement	14
Loss before taxes	(1,054)
Benefit from taxes	(126)
Net loss	$ (928)
Net loss per share:	
Basic	$ (0.31)
Diluted	$ (0.31)

(1) Cost of products, cost of services and financing interest.

Synstar

In October 2004, HP acquired approximately 99.7% of the outstanding stock of UK-based Synstar plc ("Synstar"). The purchase price was approximately $343 million, which included $298 million of cash paid as well as direct transaction costs and certain liabilities recorded in connection with the transaction. Synstar is a leading independent provider of information technology ("IT") services across Europe. This acquisition is intended to strengthen further HP's offering primarily in the area of multi-technology support services. HP recorded approximately $172 million of goodwill and $122 million of amortizable purchased intangible assets in connection with this acquisition. HP is amortizing the purchased intangibles, principally customer contracts and relationships, on a straight-line basis over their estimated useful lives ranging from three to seven years.

Note 5: Acquisitions (Continued)

Triaton

In April 2004, HP acquired all of the outstanding stock of Triaton GmbH (with subsidiaries in Singapore, China and Brazil), Triaton France SAS and Triaton N.A, Inc. (USA) (collectively "Triaton"). The purchase price was approximately $464 million, which included $306 million of cash paid as well as direct transaction costs and certain liabilities recorded in connection with the transaction. Triaton is one of Germany's largest independent IT service providers. This acquisition is intended to increase HP's capacity to deliver its Adaptive Enterprise offerings, with customers benefiting from added managed services, technology services (formerly called customer support) and consulting and integration capabilities. HP recorded approximately $285 million of goodwill and $179 million of amortizable purchased intangible assets in connection with this acquisition. HP is amortizing the purchased intangibles, principally customer contracts and relationships, on a straight-line basis over their estimated useful lives ranging from two to eight years.

Digital GlobalSoft Limited

In fiscal 2004, HP paid approximately $315 million in cash for additional shares of Digital GlobalSoft Limited, a consolidated subsidiary of HP ("DGS"), to increase HP's ownership from 50.1% to approximately 97.2%. DGS is a globally-focused software development and IT services company. This subsidiary has enhanced HP's capability in IT services, including expertise in life cycle services such as migration, technical and application services. HP recorded approximately $281 million of goodwill in connection with this acquisition.

Intria-HP

In November 2002, HP acquired the remaining outstanding stock of Intria Corporation ("Intria"), in which HP held a 49% equity interest at October 31, 2002, and other related IT assets from Canadian Imperial Bank of Commerce ("CIBC"), for approximately $100 million in cash. Intria is a provider of managed services, which HP jointly owned with CIBC. In connection with the acquisition, HP also entered into a multi-year contract to provide managed services to CIBC. This acquisition and the outsourcing relationship with CIBC have added depth and capability to HPS, including expertise in managing complex, heterogeneous IT operating environments for customers in the financial services industry and others that demand high availability computing solutions. HP recorded approximately $27 million of goodwill and $33 million of amortizable purchased intangible assets in connection with the acquisition. HP is amortizing the purchased intangible assets, consisting mainly of customer contracts, over their estimated weighted-average useful lives ranging from three to ten years.

Indigo

In March 2002, HP acquired substantially all of the outstanding stock of Indigo N.V. ("Indigo"), not previously owned by HP in exchange for HP common stock and non-transferable contingent value rights ("CVRs") and the assumption of options to purchase Indigo common stock. This acquisition has strengthened HP's printer offerings by adding high performance digital color printing systems. The total purchase price for Indigo was approximately $719 million, which included the fair value of HP common stock issued and options assumed to purchase HP stock, as well as direct transaction costs and the cost of an equity investment made by HP in Indigo in October 2000. HP issued approximately 32 million shares of HP common stock, and a consolidated subsidiary of HP issued approximately 53 million

Note 5: Acquisitions (Continued)

CVRs, which HP guaranteed, in connection with this transaction. HP recorded approximately $499 million of goodwill and $153 million of amortizable purchased intangible assets in conjunction with the acquisition and the previous equity investment. HP is amortizing the purchased intangible assets over their estimated useful lives ranging from five to eight years. In addition, HP recorded a pre-tax charge of approximately $58 million for IPR&D at the completion of the acquisition because technological feasibility had not been established and no future alternative uses existed.

The CVRs issued in conjunction with this acquisition entitle each holder to a one-time contingent cash payment of up to $4.50 per CVR, based on the achievement of certain cumulative revenue results over a three-year period. Any liability related to the CVRs will be recorded as additional goodwill as payout thresholds are achieved. The future cash pay-out, if any, of the CVRs will be payable after a three-year period that began on April 1, 2002 and could result in a maximum obligation of $237 million. HP has not incurred a liability associated with the CVRs as of October 31, 2004.

Liquidity Management Corporation

At October 31, 2001, HP held a 49.5% equity interest in Liquidity Management Corporation ("LMC"), a non-strategic investment company, which HP accounted for under the equity method of accounting. A third party investor held the remaining 50.5% of equity interest. On November 1, 2001, LMC redeemed the outstanding equity of the third party investor, leaving HP as the sole stockholder of LMC. Accordingly, effective November 1, 2001, HP has included the assets, liabilities and results of operations of LMC in its Consolidated Financial Statements. At November 1, 2001, the assets of LMC consisted primarily of $879 million of cash and cash equivalents.

Other Acquisitions

HP also acquired other companies during fiscal 2004 and 2003 that were not significant to its financial position or results of operations. Total consideration for these acquisitions was approximately $250 million and $85 million in fiscal 2004 and 2003, respectively. HP recorded approximately $181 million of goodwill and $49 million of purchased intangibles in fiscal 2004 and $64 million of goodwill and $20 million of purchased intangibles in fiscal 2003 in connection with these other acquisitions. HP also recorded approximately $37 million and $1 million of IPR&D related to these acquisitions in fiscal 2004 and 2003, respectively.

HP has included the results of operations of all acquisitions prospectively from the respective dates of the transactions. Except for the Compaq acquisition, HP has not presented the pro forma results of operations of the acquired businesses because the results are not material to HP's consolidated results of operations individually or in the aggregate.

Acquisition-Related Charges

Acquisition-related charges of approximately $54 million in fiscal 2004 consisted of deferred compensation, merger-related inventory adjustments and professional fees, while the charges of approximately $280 million in fiscal 2003 and $701 million in fiscal 2002 were attributable primarily to costs incurred for employee retention bonuses in connection with the Compaq acquisition as well as professional fees and consulting services. In addition, acquisition-related charges in fiscal 2002 included costs incurred for proxy solicitation and advertising related to the Compaq acquisition.

Note 6: Goodwill and Purchased Intangible Assets

Goodwill

Goodwill allocated to HP's business segments as of October 31, 2003 and changes in the carrying amount of goodwill for the fiscal year ended October 31, 2004 are as follows:

	HP Services	Enterprise Storage and Servers	Software	Enterprise Systems Group	Personal Systems Group	Imaging and Printing Group	HP Financial Services	Total
				In millions				
Balance at October 31, 2003	$5,522	$ —	$ —	$ 5,390	$2,324	$1,508	$150	$14,894
Reallocation	—	4,794	596	(5,390)	—	—	—	—
Goodwill acquired during the period	740	11	168	—	—	—	—	919
Goodwill adjustment	8	5	(5)	—	3	2	2	15
Balance at October 31, 2004	$6,270	$4,810	$759	$ —	$2,327	$1,510	$152	$15,828

The goodwill reallocation shown in the table above relates to the reorganization of HP's business segments discussed in Note 18. The goodwill formerly included in the Enterprise Systems Group was allocated between ESS and Software based on a relative fair value approach.

The goodwill adjustment shown in the table above relates primarily to revisions of acquisition-related tax estimates, that resulted in additions to goodwill, offset partially by the reduction of a restructuring liability and asset impairments associated with the fiscal 2002 and 2001 pre-acquisition Compaq restructuring plans. The reduction of the restructuring liability and asset impairments adjusted original estimates to actual costs incurred at various locations throughout the world.

On November 1, 2002, HP adopted SFAS No. 142, which requires that goodwill no longer be amortized and instead be tested for impairment on a periodic basis.

Based on the results of its annual impairment tests, HP determined that no impairment of goodwill existed as of August 1, 2004 or August 1, 2003. However, future goodwill impairment tests could result in a charge to earnings. HP will continue to evaluate goodwill on an annual basis as of the beginning of its fourth fiscal quarter, and whenever events and changes in circumstances indicate that there may be a potential impairment.

If the provisions of SFAS No. 142 had been in effect for all periods presented, HP's net earnings (loss) and net earnings (loss) per share would have been unchanged for fiscal 2004 and 2003. For fiscal 2002, the net loss, basic net loss per share and diluted net loss per share would have been $796 million, $0.32 and $0.32, respectively, which represents an improvement on reported net loss, basic net loss per share and diluted net loss per share of $107 million, $0.04 and $0.04, respectively.

Note 6: Goodwill and Purchased Intangible Assets (Continued)

Purchased Intangible Assets

HP's purchased intangible assets associated with completed acquisitions at October 31 are composed of:

	2004			2003		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
			In millions			
Customer contracts, customer lists and distribution agreements	$2,340	$ (637)	$1,703	$2,040	$(371)	$1,669
Developed and core technology and patents	1,704	(775)	929	1,663	(457)	1,206
Product trademarks	93	(44)	49	84	(25)	59
Total amortizable purchased intangible assets	4,137	(1,456)	2,681	3,787	(853)	2,934
Compaq trade name	1,422	—	1,422	1,422	—	1,422
Total purchased intangible assets	$5,559	$(1,456)	$4,103	$5,209	$(853)	$4,356

Amortization expense related to finite-lived purchased intangible assets was approximately $603 million in fiscal 2004, $563 million in fiscal 2003 and $295 million in fiscal 2002.

HP performs an annual impairment test for its purchased intangible asset with an indefinite life, the Compaq trade name. Based on the results of its annual impairment tests, HP determined that no impairment of the Compaq trade name existed as of August 1, 2004 or August 1, 2003. However, future impairment tests could result in a charge to earnings. HP will continue to evaluate the purchased intangible asset with an indefinite life on an annual basis as of the beginning of the fourth quarter, and whenever events and changes in circumstances indicate that there may be a potential impairment.

The finite-lived purchased intangible assets consist of customer contracts, customer lists and distribution agreements, which have weighted average useful lives of approximately eight years, and developed and core technology, patents and product trademarks, which have weighted average useful lives of approximately six years.

Estimated future amortization expense related to finite-lived purchased intangible assets at October 31, 2004 is as follows:

Fiscal year:	In millions
2005	$ 574
2006	530
2007	462
2008	396
2009	321
Thereafter	398
Total	$2,681

Note 7: Restructuring Charges

Fiscal 2003 Restructuring Plans

In the second, third and fourth quarters of fiscal 2003, HP's management approved and implemented plans to restructure certain of its operations. These plans were entered into with the intent of better managing HP's cost structure and aligning certain of its operations more effectively with current businesses conditions. The initial charge for these actions totaled $752 million and included costs of $639 million relating to severance and other employee benefits for workforce reductions, costs of $42 million for vacating duplicative facilities (leased or owned) and contract termination costs, as well as asset impairments of $71 million associated with the identification of duplicative assets and facilities (leased or owned) relating to the acquisition of Compaq. During fiscal 2004, HP recorded $37 million of additional charges under the 2003 restructuring plans which represented changes in original estimates as well as new charges that did not meet the recognition criteria during fiscal 2003 and accordingly were charged to expense as incurred in fiscal 2004. Certain adjustments to the original estimates for each operating segment were reflected in the total of costs incurred and expected. The adjustments had the effect of decreasing the estimated costs to be incurred for the PSG segment by approximately $48 million and increasing the estimated costs to be incurred for the remaining segments by approximately $54 million.

Original estimates of 2,300, 4,700 and 2,000 employees across many regions and job classes were included in the second third and fourth quarter workforce reduction plans, respectively, for a total of 9,000 employees. As of October 31, 2004, approximately 8,300 of these employees had been terminated, placed in the workforce reduction programs or had retired. They consisted of substantially all of the employees included in the second and third quarter actions and a majority of the employees in the fourth quarter action. An additional 300 employees under the fourth quarter action are expected to leave during fiscal 2005, bringing the total estimated number of employees affected under the 2003 plans to 8,600, a reduction of 400 employees from the original estimate. HP expects to pay out the majority of the remaining costs relating to severance and other employee benefits in connection with the remainder of the fourth quarter action during fiscal 2005. Some minor remaining severance and other employee benefits are expected to be paid out under phased retirement plans required in certain international locations by the end of fiscal 2010. HP anticipates the remaining costs of vacating duplicative facilities and contract terminations associated with the second and fourth quarter actions to be substantially settled by the end of fiscal 2005. In addition, approximately $6 million of costs related to the 2003 plans have not yet been accrued and will be charged to operations as the restructuring activities occur during fiscal 2005.

Fiscal 2002 Restructuring Plans

In fiscal 2002, HP's management initiated and approved plans to restructure the operations of both the pre-acquisition HP and pre-acquisition Compaq organizations. Consequently, HP recorded approximately $1.8 billion of costs associated with exiting the activities of pre-acquisition HP such as severance, early retirement and other employee benefits, costs of vacating duplicative facilities (leased or owned), contract termination costs, asset impairment charges and other costs associated with exiting activities of HP. These costs were included as a charge to the results of operations for the fiscal year ended October 31, 2002. In addition, HP recorded approximately $960 million of similar charges in connection with restructuring the pre-acquisition Compaq organization. HP recognized these costs as a liability assumed in the purchase and were included in the allocation of the cost to acquire Compaq. In fiscal 2004 and 2003, HP recorded $75 million and $48 million, respectively of additional costs, net of

Note 7: Restructuring Charges (Continued)

reductions, in estimated severance and other employee benefits, as well as asset impairment and other restructuring costs related to the fiscal 2002 restructuring plans. Additionally, in fiscal 2004 and 2003, HP recorded adjustments to reduce goodwill of $71 million and $94 million, respectively. These adjustments related to true-ups to the fiscal pre-merger Compaq 2002 restructuring plan. These fiscal 2004 and 2003 adjustments included changes to asset impairments for buildings vacated as part of the acquisition and adjustments to restructuring liabilities for changes in severance estimates and contract termination costs.

The severance, early retirement costs and other employee benefits related to the termination or planned early retirement of an originally estimated 17,900 employees worldwide across many regions, business functions and job classes. As of October 31, 2004, approximately 17,600 employees included in the workforce reduction program had been terminated or had retired, a reduction of 300 employees from the original estimate. HP expects to pay the majority of the remaining balance of the severance costs by the end of fiscal 2005. HP anticipates paying the remaining balance of the costs for the other related restructuring activities, which consist primarily of contractual obligations such as facility leases, over the lives of the related obligations, which extend to the end of fiscal 2010.

Fiscal 2001 Restructuring Plans

In fiscal 2001, HP's management approved restructuring actions to respond to the global economic downturn and to improve HP's cost structure by streamlining operations and prioritizing resources in strategic areas of HP's business infrastructure. HP recorded a restructuring charge of $384 million in fiscal 2001 to reflect these actions which consisted primarily of severance and other employee benefits related to termination of 7,500 employees worldwide. During fiscal 2002, HP recorded $21 million of additional charges to reflect adjustments to the expected severance cost of its fiscal 2001 plan. As of the end of fiscal 2003, HP had terminated substantially all of these employees were terminated and paid substantially all accrued costs.

As part of the acquisition of Compaq, HP assumed the remaining obligations of Compaq's existing restructuring plans of $259 million, which Compaq initially recorded in its 2001 fiscal year. In fiscal 2004 and 2003, HP recorded adjustments to decrease goodwill related to true-ups to these plans of $2 million and $26 million, respectively. The remaining balance of the pre-merger Compaq fiscal 2001 plan consists primarily of severance and other employee benefits as well as other restructuring costs. HP expects to settle the majority of the remaining balance of the severance accrual under phased retirement plans required in certain international locations by the end of fiscal 2009. HP anticipates paying the other related restructuring activities, which consist primarily of contractual obligations such as facility leases, over the lives of the related obligations, which extend to the end of fiscal 2010.

Note 7: Restructuring Charges (Continued)

Summary of Restructuring Plans

The activity in the accrued restructuring balances related to all of the plans described above was as follows for fiscal 2004:

	Balance, October 31, 2003	Fiscal year 2004 charges (reversals)	Goodwill adjust-ments	Cash payments	Non-cash settle-ments and other adjust-ments	Balance, October 31, 2004	Fiscal year 2003 costs and adjustments	Fiscal year 2002 costs and adjustments	As of October 31, 2004 Total costs and adjustments to date	As of October 31, 2004 Total expected costs and adjustments
						In millions				
Fiscal 2003 plans:										
Employee severance and other benefits charges (by segment and other):										
Enterprise Storage and Servers		$ 13					$ 140		$ 153	$ 153
Software		—					13		13	13
Personal Systems Group		(48)					99		51	51
HP Services		21					328		349	349
Infrastructure		20					59		79	79
Employee severance and other benefits	$239	$ 6	$ —	$(191)	$ 3	$ 57	$ 639		$ 645	$ 645
Infrastructure—asset impairments	—	6	—	—	(6)	—	71		77	77
Infrastructure—other related restructuring activities	37	25	—	(41)	—	21	42		67	73
Total	$276	$ 37	$ —	$(232)	$(3)	$ 78	$ 752		$ 789	$ 795
Fiscal 2002 pre-merger HP plan:										
Employee severance and other benefits	$127	$ 21	$ —	$(143)	$ 2	$ 7	$ 32	$1,029	$1,082	$1,082
Asset impairments	—	—	—	—	—	—	65	546	611	611
Other related restructuring activities	45	5	—	(34)	—	16	(49)	184	140	140
Total	$172	$ 26	$ —	$(177)	$ 2	$ 23	$ 48	$1,759	$1,833	$1,833
Fiscal 2002 pre-merger Compaq plan:										
Employee severance and other benefits	$ 73	$ 17	$ —	$ (83)	$—	$ 7	$ (36)	$ 651	$ 632	$ 632
Asset impairments	—	—	(42)	—	42	—	(3)	—	(45)	(45)
Other related restructuring activities	175	32	(29)	(87)	—	91	(55)	309	257	257
Total	$248	$ 49	$ (71)	$(170)	$42	$ 98	$ (94)	$ 960	$ 844	$ 844
Fiscal 2001 pre-merger HP plan:										
Employee severance and other benefits	$ 2	$ —	$ —	$ (2)	$—	$ —	$ —	$ 21	$ 393	$ 393
Other related restructuring activities	1	2	—	—	—	3	—	—	14	14
Total	$ 3	$ 2	$ —	$ (2)	$—	$ 3	$ —	$ 21	$ 407	$ 407
Fiscal 2001 pre-merger Compaq plan:										
Employee severance and other benefits	$ 24	$ —	$ —	$ (5)	$—	$ 19	$ (32)	$ 117	$ 85	$ 85
Other related restructuring activities	84	—	(2)	(15)	—	67	6	142	146	146
Total	$108	$ —	$ (2)	$ (20)	$—	$ 86	$ (26)	$ 259	$ 231	$ 231
Total restructuring plans	$807	$114	$ (73)	$(601)	$41	$288				

At October 31, 2004 and October 31, 2003, HP included the long-term portion of the restructuring liability of $95 million and $98 million, respectively, in Other liabilities in the accompanying Consolidated Balance Sheets.

Note 8: Financial Instruments

Investments in Debt and Equity Securities

Investments in available-for-sale debt and equity securities at fair value were as follows at October 31:

	2004				2003			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	In millions							
Available-for-Sale Securities								
Debt securities:								
Municipal securities					$ 81			$ 81
Repurchase agreements	$ 70	$—	$—	$ 70	120	$ 8	$ —	128
Time deposits	263	—	—	263	216	—	—	216
Other debt securities	—	—	—	—	61	2	—	63
Total debt securities	333	—	—	333	478	10	—	488
Equity securities in public companies	35	40	(5)	70	35	63	(1)	97
	$368	$40	$ (5)	$403	$513	$73	$ (1)	$585

Other debt securities consist primarily of collateralized notes with banks and corporate debt securities. Equity securities in public companies are primarily common stock.

HP estimated the fair values based on quoted market prices or pricing models using current market rates. These estimated fair values may not be representative of actual values of the financial instruments that could have been realized as of year-end or that will be realized in the future.

In May 2003, HP sold an investment in a debt security with a net book value of $65 million classified as a held-to-maturity security. The proceeds of this sale were used for operating purposes. As the book value of the debt security approximated the market value on the date of sale, the realized loss associated with this sale was not material. As a result of this transaction, HP reclassified all held-to-maturity securities, composed of approximately $200 million in time deposits, into available-for-sale securities. The book value of these securities approximated the estimated fair value and the net unrealized loss, which was not material, was recognized in accumulated other comprehensive loss as a separate component of stockholders' equity.

The gross unrealized losses as of October 31, 2004 and 2003 were associated with investments in public equity securities with a fair value of $9 million and $1 million, respectively, and have been in a continuous loss position for less than 12 months.

Note 8: Financial Instruments (Continued)

Contractual maturities of available-for-sale debt securities were as follows at October 31, 2004:

	Available-for-Sale Securities	
	Cost	Estimated Fair Value
	In millions	
Due in less than one year	$311	$311
Due in 1-5 years	22	22
	$333	$333

Proceeds from sales or maturities of available-for-sale and other securities were $1.1 billion in fiscal 2004, $588 million in fiscal 2003 and $90 million in fiscal 2002. The gross realized gains and losses totaled $27 million and $4 million, respectively, in fiscal 2004. Gross realized gains and losses totaled $36 million and $8 million, respectively, in fiscal 2003. Gross realized losses totaled $2 million in fiscal 2002. The specific identification method is used to account for gains and losses on available-for-sale securities. A summary of the carrying values and balance sheet classification of all investments in debt and equity was as follows at October 31:

	2004	2003
	In millions	
Available-for-sale debt securities	$ 311	$ 403
Short-term investments	311	403
Available-for-sale debt securities	22	85
Available-for-sale equity securities	70	97
Equity securities in privately-held companies and other investments	388	577
Included in long-term financing receivables and other assets	480	759
Total investments	$ 791	$1,162

Derivative Financial Instruments

HP is a global company that is exposed to foreign currency exchange rate fluctuations and interest rate changes in the normal course of its business. As part of its risk management strategy, HP uses derivative instruments, including forward contracts, swaps and options to hedge certain foreign currency and interest rate exposures. HP's objective is to offset gains and losses resulting from these exposures with losses and gains on the derivative contracts used to hedge them, respectively, thereby reducing volatility of earnings or protecting fair values of assets and liabilities. HP does not use derivative contracts for speculative purposes. HP applies hedge accounting based upon the criteria established by SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," whereby HP designates its derivatives as fair value hedges, cash flow hedges or net investment hedges.

Fair Value Hedges

HP enters into fair value hedges to reduce the exposure of its debt and investment portfolios to both interest rate risk and foreign currency exchange rate risk. HP issues long-term debt in either U.S.

Note 8: Financial Instruments (Continued)

dollars or foreign currencies based on market conditions at the time of financing. HP then typically uses interest rate swaps to modify the market risk exposures in connection with the debt to achieve primarily U.S. dollar LIBOR-based floating interest expense and to manage exposure to changes in foreign currency exchange rates. The swap transactions generally involve the exchange of fixed for floating interest payment obligations and, when the underlying debt is denominated in a foreign currency, exchange of the foreign currency principal and interest obligations for U.S. dollar-denominated amounts. Alternatively, HP may choose not to swap fixed debt to a floating rate or may terminate a previously executed swap if the fixed rate positions provide a more beneficial relationship between assets and liabilities. Similarly, HP may choose not to hedge the foreign currency risk associated with its foreign currency-denominated debt if this debt acts as a natural foreign currency hedge for assets denominated in the same currency. In order to hedge the fair value of certain fixed-rate investments, HP periodically may enter into interest rate swaps that convert fixed interest returns into variable interest returns. As of October 31, 2004, HP had a total notional amount of approximately $6 billion in fair value hedges. For derivative instruments that are designated and qualify as fair value hedges, HP recognizes the gain or loss on the derivative instrument, as well as the offsetting loss or gain on the hedged item, in earnings in the current period. In September 2002, HP terminated an interest rate swap that effectively converted fixed rate interest to variable rate interest on debt that matures in 2005. The deferred gain of $185 million on this termination is being amortized as a reduction of interest expense over the remaining life of the underlying debt. During fiscal 2004 and 2003, HP's interest rate swap terminations were not material.

Cash Flow Hedges

HP uses cash flow hedges to hedge the variability of LIBOR-based interest income received on certain variable-rate investments. HP enters into interest rate swaps that convert variable rate interest returns into fixed-rate interest returns. As of October 31, 2004, HP had a total notional amount of $250 million in interest rate swaps classified as cash flow hedges. For interest rate swaps that are designated and qualify as cash flow hedges, changes in the fair values are recorded in accumulated other comprehensive income as a separate component of stockholders' equity and subsequently are reclassified into earnings in the period during which the hedged transaction is recognized in earnings.

HP uses a combination of forward contracts and options designated as cash flow hedges to protect against the foreign currency exchange rate risks inherent in its forecasted net revenue and, to a lesser extent, cost of sales denominated in currencies other than the U.S. dollar. HP's foreign currency cash flow hedges mature generally within six months. However, certain leasing revenue-related forward contracts extend for the duration of the lease term, which can be up to five years. As of October 31, 2004, HP had a total notional amount of $4.9 billion of forwards and options. For derivative instruments that are designated and qualify as cash flow hedges, HP initially records the effective portions of the gain or loss on the derivative instrument in accumulated other comprehensive income as a separate component of stockholders' equity and subsequently reclassifies these amounts into earnings in the period during which the hedged transaction is recognized in earnings. HP reports the ineffective portion of the gain or loss, if any, in other income or expense immediately. HP reports the effective portion of cash flow hedges in the same financial statement line item as the changes in value of the hedged item. As of October 31, 2004, HP expects $98 million of derivative losses included in accumulated other comprehensive income to be reclassified into earnings within the next twelve months.

Note 8: Financial Instruments (Continued)

Net Investment Hedges

HP uses forward contracts designated as net investment hedges to hedge net investments in certain foreign subsidiaries whose functional currency is the local currency. As of October 31, 2004, HP had a total notional amount of $750 million in forward contracts. For derivative instruments that are designated as net investment hedges, HP records the effective portion of the gain or loss on the derivative instrument in cumulative translation adjustment as a separate component of stockholders' equity. The loss on net investment hedges included in cumulative translation adjustment was $43 million and $18 million in the fiscal years ended October 31, 2004 and 2003, respectively. HP reports the effective portion of net investment hedges in the same financial statement line item as the changes in value of the hedged item.

Other Derivatives

Other derivatives not designated as hedging instruments under SFAS No. 133 consist primarily of forward contracts used to hedge foreign currency balance sheet exposures and warrants in companies invested in as part of strategic relationships. As of October 31, 2004, HP had a total notional amount of $14 billion in other derivatives not designated as hedging instruments. For derivative instruments not designated as hedging instruments under SFAS No. 133, HP recognizes changes in the fair values in earnings in the period of change. HP recognizes the gains and losses on foreign currency forward contracts used to hedge balance sheet exposures in interest and other, net in the same period as the remeasurement gain and loss of the related foreign currency denominated assets and liabilities and thus naturally offsets these gains and losses. HP recognized net foreign currency exchange losses of approximately $142 million in fiscal 2004, $125 million in fiscal 2003 and $165 million in fiscal 2002 which related primarily to forward points in its hedging contracts.

Hedge Effectiveness

For interest rate swaps designated as fair value hedges, HP measures effectiveness by offsetting the change in fair value of the hedged debt or investment with the change in fair value of the derivative. For interest rate swaps designated as cash flow hedges, HP measures the hedging effectiveness by offsetting the change in the variable portion of the interest rate swaps with the changes in expected interest income received due to the fluctuations in the LIBOR based interest rate. For foreign currency option and forward contracts designated as cash flow or net investment hedges, HP measures hedge effectiveness by comparing the cumulative change in the hedge contract with the cumulative change in the hedged item, both of which are based on forward rates. Any ineffective portion of the hedge, as well as amounts not included in the assessment of effectiveness, are recognized in interest and other, net. As of October 31, 2004, the portion of hedging instruments' gains or losses excluded from the assessment of effectiveness was not material for fair value, cash flow or net investment hedges. Hedge ineffectiveness for fair value, cash flow and net investment hedges was not material in the fiscal years ended October 31, 2004, 2003 and 2002. As of October 31, 2004, amounts related to derivatives qualifying as cash flow hedges amounted to a reduction of accumulated other comprehensive income of $115 million, net of tax, of which $98 million was expected to be transferred to earnings in the next 12 months along with the earnings effects of the related forecasted transactions. In addition, during fiscal 2004 and 2003 HP did not discontinue any cash flow hedges for which it was probable that a forecasted transaction would not occur.

Note 8: Financial Instruments (Continued)

HP estimates the fair values of derivatives based on quoted market prices or pricing models using current market rates and records all derivatives on the balance sheet at fair value. The fair market value of derivative financial instruments and the respective SFAS No. 133 classification on the Consolidated Balance Sheets was as follows at October 31:

	2004				
	Other Current Assets	Long-term Financing Receivables and Other Assets	Other Accrued Liabilities	Other Liabilities	Total
			In millions		
Fair value hedges	$ 3	$ 26	$ —	$ (21)	$ 8
Cash flow hedges	11	4	(143)	(14)	(142)
Net investment hedges	—	—	(43)	—	(43)
Other derivatives	131	8	(345)	(71)	(277)
Total	$145	$ 38	$(531)	$(106)	$(454)

	2003				
	Other Current Assets	Long-term Financing Receivables and Other Assets	Other Accrued Liabilities	Other Liabilities	Total
			In millions		
Fair value hedges	$ —	$120	$ —	$(55)	$ 65
Cash flow hedges	21	—	(126)	(21)	(126)
Net investment hedges	—	—	(18)	—	(18)
Other derivatives	155	28	(529)	—	(346)
Total	$176	$148	$(673)	$(76)	$(425)

Fair Value of Other Financial Instruments

For certain of HP's financial instruments, including cash and cash equivalents, short-term investments, accounts receivable, financing receivables, notes payable and short-term borrowings, accounts payable and other accrued liabilities, the carrying amounts approximate fair value due to their short maturities. The estimated fair value of HP's short- and long-term debt was approximately $6.9 billion at October 31, 2004, compared to a carrying value of $7.1 billion at that date. The estimated fair value of the debt is based primarily on quoted market prices, as well as borrowing rates currently available to HP for bank loans with similar terms and maturities.

Note 9: Financing Receivables and Operating Leases

Financing receivables represent sales-type and direct-financing leases resulting from the marketing of HP's and complementary third-party products. These receivables typically have terms from two to five years and are usually collateralized by a security interest in the underlying assets. Financing receivables also include billed receivables from operating leases. The components of net financing

Note 9: Financing Receivables and Operating Leases (Continued)

receivables, which are included in financing receivables and long-term financing receivables and other assets, were as follows at October 31:

	2004	2003
	In millions	
Minimum lease payments receivable	$ 5,328	$ 6,010
Allowance for doubtful accounts	(213)	(210)
Unguaranteed residual value	394	446
Unearned income	(396)	(475)
Financing receivables, net	5,113	5,771
Less current portion	(2,945)	(3,026)
Amounts due after one year, net	$ 2,168	$ 2,745

Scheduled maturities of HP's minimum lease payments receivable are as follows at October 31, 2004:

	2005	2006	2007	2008	2009	Thereafter	Total
				In millions			
Scheduled maturities of minimum lease payments receivable	$ 3,045	$ 1,381	$ 612	$ 194	$ 67	$ 29	$ 5,328

Equipment leased to customers under operating leases was $2.3 billion at October 31, 2004 and $2.1 billion at October 31, 2003, and is included in machinery and equipment. Accumulated depreciation on equipment under lease was $0.9 billion at October 31, 2004 and $1.2 billion at October 31, 2003. Minimum future rentals on non-cancelable operating leases related to leased equipment are as follows at October 31, 2004:

	2005	2006	2007	2008	2009	Thereafter	Total
				In millions			
Minimum future rentals on non-cancelable operating leases	$ 824	$ 404	$ 103	$ 18	$ 3	$ 11	$ 1,363

Note 10: Guarantees

Indemnifications

In the ordinary course of business, HP enters into contractual arrangements under which HP may agree to indemnify the third party to such arrangement from any losses incurred relating to the services they perform on behalf of HP or for losses arising from certain events as defined within the particular contract, which may include, for example, litigation or claims relating to past performance. Such indemnification obligations may not be subject to maximum loss clauses. Historically, payments made related to these indemnifications have been immaterial.

Warranty

HP provides for the estimated cost of product warranties at the time it recognizes revenue. HP engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its component suppliers; however, product warranty terms offered to

Note 10: Guarantees (Continued)

customers, ongoing product failure rates, material usage and service delivery costs incurred in correcting a product failure, as well as specific product class failures outside of HP's baseline experience, affect the estimated warranty obligation. If actual product failure rates, material usage or service delivery costs differ from estimates, revisions to the estimated warranty liability would be required.

Information regarding the changes in HP's aggregate product warranty liabilities is as follows at October 31:

	2004	2003
	In millions	
Product warranty liability at beginning of year	$ 1,987	$ 2,157
Accruals for warranties issued	2,504	2,233
Adjustments related to pre-existing warranties (including changes in estimates)	(86)	(17)
Settlements made (in cash or in kind)	(2,365)	(2,386)
Product warranty liability at end of year	$ 2,040	$ 1,987

Deferred Revenue

The components of deferred revenue were as follows at October 31:

	2004	2003
	In millions	
Deferred support contract services revenue	$2,780	$2,535
Other deferred revenue	1,568	1,130
Total deferred revenue	4,348	3,665
Less current portion	2,958	2,496
Long-term deferred revenue	$1,390	$1,169

Deferred support contract services revenue represents amounts received or billed in advance primarily for fixed-price support or maintenance contracts. These services include stand-alone product support packages, routine maintenance service contracts, upgrades or extensions to standard product warranty, as well as high availability services for complex, global, networked, multi-vendor environments. These service amounts are deferred at the time the customer is billed and then recognized ratably over the contract life or as the services are rendered.

Other deferred revenue represents amounts received or billed in advance for contracts related primarily to consulting and integration projects, managed services start-up or transition work, as well as minor amounts for training, and product sales. HP recognizes the majority of these amounts as revenue based on the proportional performance method.

Note 11: Borrowings

Notes Payable and Short-Term Borrowings

Notes payable and short-term borrowings, including the current portion of long-term debt, were as follows at October 31:

	2004		2003	
	Amount Outstanding	Weighted Average Interest Rate	Amount Outstanding	Weighted Average Interest Rate
	In millions			
Current portion of long-term debt	$1,861	7.1%	$ 281	6.3%
Commercial paper	306	2.2%	437	2.0%
Notes payable to banks, lines of credit and other	344	2.4%	362	1.7%
	$2,511		$1,080	

Notes payable to banks, lines of credit and other includes deposits, primarily by banks, of approximately $241 million and $192 million at October 31, 2004 and 2003, respectively.

Long-Term Debt

Long-term debt was as follows at October 31:

	2004	2003
	In millions	
U.S. Dollar Global Notes		
$1,500 issued June 2000 at 7.15%, due June 2005	$ 1,499	$1,498
$1,000 issued December 2001 at 5.75%, due December 2006	998	997
$1,000 issued June 2002 at 5.5%, due July 2007	997	996
$500 issued June 2002 at 6.5%, due July 2012	498	498
$500 issued March 2003 at 3.625%, due March 2008	498	497
	4,490	4,486
Euro Medium-Term Note Programme		
€750 issued July 2001 at 5.25%, due July 2006	954	870
Series A Medium-Term Notes		
$60 issued September 2001 at a floating rate, due September 2004	—	60
$200 issued December 2002 at 3.375%, due December 2005	200	199
$50 issued in December 2002 at 4.25%, due December 2007	50	50
	250	309
Other		
$300, Medium-Term Notes assumed from Compaq, issued at 7.65%, due August 2005	300	300
$505, U.S. dollar zero-coupon subordinated convertible notes, issued in October and November 1997 at an imputed rate of 3.13%, due 2017 (“LYONs”)	338	328
Other, including capital lease obligations, at 3.96%-9.17%, due 2003-2023	108	316
	446	644
Fair value adjustment related to SFAS No. 133	44	166
Less current portion	(1,861)	(281)
	$ 4,623	$6,494

Note 11: Borrowings (Continued)

HP may redeem some or all of the Global Notes, Medium Term Notes, Series A Medium Term Notes and the Euro Medium-Term Notes (collectively, the "Notes"), as set forth in the above table, at any time at the redemption prices described in the prospectus supplements relating thereto. The Notes are senior unsecured debt.

The LYONs are convertible by the holders at an adjusted rate of 15.09 shares of HP common stock for each $1,000 face value of the LYONs, payable in either cash or common stock at HP's election. At any time, HP may redeem the LYONs at book value, payable in cash only. In December 2000, the Board of Directors authorized a repurchase program for the LYONs that allowed HP to repurchase the LYONs from time to time at varying prices. In fiscal 2002, HP repurchased $257 million in face value of the LYONs with a book value of $158 million for an aggregate purchase price of $127 million, resulting in a gain of $31 million. The gain is included in Gains (losses) on investments and early extinguishment of debt in the Consolidated Statements of Operations. HP did not repurchase any LYONs in fiscal 2004 or 2003.

HP established a $4.0 billion U.S. commercial paper program in December 2000. Hewlett-Packard International Bank PLC, a wholly-owned subsidiary of HP, established a $500 million Euro Commercial Paper/Certificate of Deposit Programme in May 2001.

HP's $1.7 billion 364-day credit facility expiring in March 2004 and $1.3 billion three-year credit facility expiring in March 2005 were replaced with a $1.5 billion 364-day credit facility and a $1.5 billion five-year credit facility, respectively, in March 2004 (together, the "Credit Facilities"). Interest rates and other terms of borrowing under the Credit Facilities vary, as applicable, based on HP's external credit ratings. The Credit Facilities, which are subject to weighted average commitment fees of eight basis points per annum on the unused portion, are senior unsecured committed borrowing arrangements and available for general corporate purposes, including supporting the issuance of commercial paper.

HP also maintains, through various foreign subsidiaries, lines of credit from a number of financial institutions.

HP registered the sale of up to $3.0 billion of debt or global securities ("Global Notes"), common stock, preferred stock, depositary shares and warrants under a shelf registration statement in March 2002 (the "2002 Shelf Registration Statement"). In December 2002, HP filed a supplement to the 2002 Shelf Registration Statement, which allows HP to offer from time to time up to $1.5 billion of Medium-Term Notes, Series B, due nine months or more from the date of issuance (the "Series B Medium-Term Note Program"). HP may redeem any Series B Medium-Term Notes at any time at the redemption prices described in the prospectus supplements relating thereto. As of October 31, 2004, HP has not issued Medium-Term Notes pursuant to the Series B Medium-Term Note Program.

HP registered the sale of up to $3.0 billion of Medium-Term Notes under its Euro Medium-Term Note Programme filed with the Luxembourg Stock Exchange and has offered such notes as set forth in the table above. HP can denominate these notes in any currency including the Euro. However, these notes have not been and will not be registered in the United States.

At October 31, 2004, HP has available borrowing resources of up to $12.7 billion under the 2002 registration statement, credit facilities and other programs described above.

Note 11: Borrowings (Continued)

Aggregate future maturities of debt at face value (including the fair value adjustment related to SFAS No. 133 of $44 million) are as follows at October 31, 2004:

	2005	2006	2007	2008	2009	Thereafter	Total
				In millions			
Aggregate future maturities of debt outstanding including capital lease obligations	$ 1,861	$ 1,169	$ 2,006	$ 561	$ 4	$ 1,067	$ 6,668

Interest expense on borrowings was $247 million in fiscal 2004, $277 million in fiscal 2003 and $212 million in fiscal 2002.

Note 12: Taxes on Earnings

The provision for (benefit from) taxes on earnings was as follows for the fiscal years ended October 31:

	2004	2003	2002
		In millions	
U.S. federal taxes:			
Current	$ 302	$(127)	$(768)
Deferred	(161)	(254)	(1)
Non-U.S. taxes:			
Current	516	533	334
Deferred	187	159	202
State taxes:			
Current	(96)	57	100
Deferred	(49)	(19)	15
	$ 699	$ 349	$(118)

Note 12: Taxes on Earnings (Continued)

The significant components of deferred tax assets and deferred tax liabilities were as follows at October 31:

	2004		2003	
	Deferred Tax Assets	Deferred Tax Liabilities	Deferred Tax Assets	Deferred Tax Liabilities
	In millions			
Loss carryforwards	$ 403	$ —	$ 430	$ —
Credit carryforwards	678	—	1,241	—
Unremitted earnings of foreign subsidiaries	—	2,347	—	1,764
Inventory valuation	143	81	263	133
Intercompany transactions—profit in inventory	587	—	465	—
Intercompany transactions—excluding inventory	1,814	—	1,215	—
Fixed assets	196	13	324	18
Warranty	595	—	579	—
Employee and retiree benefits	1,067	205	974	51
Accounts receivable allowance	186	—	247	21
Capitalized research and development	2,582	—	1,775	—
Purchased intangible assets	219	832	293	836
Restructuring	90	—	231	—
Equity investments	289	—	396	—
Other	673	47	728	299
Gross deferred tax assets and liabilities	9,522	3,525	9,161	3,122
Valuation allowance	(447)	—	(400)	—
Total deferred tax assets and liabilities	$9,075	$3,525	$8,761	$3,122

At October 31, 2004, HP had a deferred tax asset of $403 million in loss carryforwards, of which $398 million relates to foreign net operating losses. HP has provided a valuation allowance of $321 million on those foreign net operating loss carryforwards which are not likely to be utilized. Of the total tax credit carryforwards of $678 million, HP had alternative minimum tax credit carryforwards of $391 million, which do not expire, and research and development credit carryforwards of $83 million, which will expire in fiscal 2023 and 2024. HP also had tax credits of $204 million in foreign countries, on which HP has provided a valuation allowance of $29 million.

Gross deferred tax assets at October 31, 2004 and 2003 were reduced by valuation allowances of $447 million and $400 million, respectively. At October 31, 2004, in addition to $350 million of valuation allowances on foreign net operating losses and tax credits, HP had valuation allowances of $92 million and $5 million on unrealized capital losses and other items, respectively. Of the $447 million in valuation allowances at October 31, 2004, $139 million was related to certain Compaq deferred tax assets existing at the time of the acquisition. In the future, if we determine that the realization of these Compaq deferred tax assets is more likely than not, the reversal of the related valuation allowance will reduce goodwill instead of the provision for taxes.

Of the total tax benefits resulting from the exercise of employee stock options and other employee stock programs, the amounts booked to stockholders' equity were approximately $35 million in fiscal 2004, $24 million in fiscal 2003 and $21 million in fiscal 2002.

Note 12: Taxes on Earnings (Continued)

The differences between the U.S. federal statutory income tax rate (benefit) and HP's effective tax rate (benefit) were as follows for the fiscal years ended October 31:

	2004	2003	2002
U.S. federal statutory income tax rate	35.0%	35.0%	(35.0)%
State income taxes, net of federal tax benefit	(2.3)	0.8	6.9
Lower rates in other jurisdictions, net	(15.3)	(23.9)	(36.0)
Goodwill	—	—	17.5
In-process research and development	0.1	—	27.2
Acquisition-related charges	—	—	7.1
Divestitures	—	—	(12.9)
Research and development credit	(0.6)	(1.9)	(3.9)
Valuation allowance	1.1	1.2	16.7
Other, net	(1.3)	0.9	0.8
	16.7%	12.1%	(11.6)%

In fiscal 2004, the tax rate benefited from net favorable adjustments to previously estimated tax liabilities of $207 million, which decreased the provision for taxes by approximately $0.07 per share. Excluding these adjustments, our tax rate for the year would have been 21.6%. The most significant favorable adjustments related to the resolution of a California state tax audit, a net favorable revision to estimated tax accruals upon filing the 2003 U.S. income tax return, and a reduction in taxes on foreign earnings due to a change in regulatory policy. These favorable adjustments were offset in part by the net effect of smaller adjustments to income tax liabilities in various jurisdictions.

The domestic and foreign components of earnings (losses) were as follows for the fiscal years ended October 31:

	2004	2003	2002
		In millions	
U.S.	$ (603)	$ 661	$(3,655)
Non-U.S.	4,799	2,227	2,634
	$4,196	$2,888	$(1,021)

As a result of certain employment actions and capital investments undertaken by HP, income from manufacturing activities in certain countries is subject to reduced tax rates, and in some cases is wholly exempt from taxes, through fiscal 2018. The gross income tax benefits attributable to the tax status of these subsidiaries were estimated to be approximately $947 million ($0.31 per share) in fiscal 2004, $705 million ($0.23 per share) in fiscal 2003 and $473 million ($0.19 per share) in fiscal 2002. The gross income tax benefits were offset partially by accruals of U.S. income taxes on undistributed earnings, among other factors.

The Internal Revenue Service ("IRS") has completed its examination of the income tax returns of HP for all years through 1998 and of Compaq for all years through 1997. HP's tax years from 1993 through 1998 are currently before the IRS's Appeals Division. As of October 31, 2004, the IRS was in the process of examining HP's income tax returns for years 1999 through 2003 and Compaq's income tax returns for years 1998 through 2002. In addition, HP is subject to numerous ongoing audits by state

Note 12: Taxes on Earnings (Continued)

and foreign tax authorities. HP believes that adequate accruals for HP and Compaq have been provided for all years.

HP has not provided for U.S. federal income and foreign withholding taxes on $15.0 billion of undistributed earnings from non-U.S. operations as of October 31, 2004 because such earnings are intended to be reinvested indefinitely outside of the United States. Where excess cash has accumulated in HP's non-U.S. subsidiaries and it is advantageous for business operations, tax or cash reasons, subsidiary earnings are remitted. If these earnings were distributed, foreign tax credits may become available under current law to reduce or eliminate the resulting U.S. income tax liability. HP has not reevaluated its position with respect to the indefinite reinvestment of foreign earnings to take into account the possible election of the repatriation provisions contained in the American Jobs Creation Act of 2004. The status of HP's evaluation of these provisions is described in the following section.

American Jobs Creation Act of 2004—Repatriation of Foreign Earnings

The American Jobs Creation Act of 2004 (the "Jobs Act"), enacted on October 22, 2004, provides for a temporary 85% dividends received deduction on certain foreign earnings repatriated during a one-year period. The deduction would result in an approximate 5.25% federal tax rate on the repatriated earnings. To qualify for the deduction, the earnings must be reinvested in the United States pursuant to a domestic reinvestment plan established by a company's chief executive officer and approved by the company's board of directors. Certain other criteria in the Jobs Act must be satisfied as well. The maximum amount of HP's foreign earnings that qualify for the temporary deduction is $14.5 billion. For HP, the one-year period during which the qualifying distributions can be made is fiscal 2005.

HP is in the process of evaluating whether it will repatriate foreign earnings under the repatriation provisions of the Jobs Act, and if so, the amount that will be repatriated. The range of reasonably possible amounts that HP is considering for repatriation, which would be eligible for the temporary deduction, is zero to $14.5 billion. HP is awaiting the issuance of further regulatory guidance and passage of statutory technical corrections with respect to certain provisions in the Jobs Act prior to determining the amounts it will repatriate. If such regulatory guidance or technical corrections are favorable, HP is likely to repatriate amounts in the high end of its range. HP expects to determine the amounts and sources of foreign earnings to be repatriated, if any, during the third quarter of fiscal 2005.

HP is not yet in a position to determine the impact of a qualifying repatriation, should it choose to make one, on its income tax expense for fiscal 2005, the amount of its indefinitely reinvested foreign earnings, or the amount of its deferred tax liability with respect to foreign earnings. If HP were to plan to repatriate the maximum amount eligible for the temporary deduction, which is $14.5 billion, from foreign earnings which were previously indefinitely reinvested, HP estimates it would accrue additional tax expense in fiscal 2005 of between $850 million and $925 million. The amount of additional tax expense accrued would be reduced if some part of the eligible dividend was attributable to foreign earnings on which a deferred tax liability had been previously accrued (that is, on non-indefinitely reinvested earnings).

Note 13: Stockholders' Equity

Dividends

The stockholders of HP common stock are entitled to receive dividends when and as declared by HP's Board of Directors. Dividends are paid quarterly. Dividends were $0.32 per common share in each of fiscal 2004, 2003 and 2002.

Employee Stock Purchase Plan

HP sponsors the Hewlett-Packard Company 2000 Employee Stock Purchase Plan, also known as the Share Ownership Plan (the "ESPP"), a non-compensatory plan where eligible employees may contribute up to 10% of base compensation, subject to certain income limits, to purchase shares of HP's common stock. The stock is purchased semi-annually at a price equal to 85% of the fair market value at certain plan-defined dates. At October 31, 2004, approximately 143,000 employees were eligible to participate, and approximately 62,000 employees were participants in the ESPP. In fiscal 2004, participants purchased 25,868,000 shares of HP common stock at a weighted-average price of $14 per share. In fiscal 2003, participants purchased 23,884,000 shares of HP common stock at a weighted-average price of $14 per share. In fiscal 2002, participants purchased 18,536,000 shares of HP common stock at a weighted-average price of $14 per share.

As of October 31, 2000 employees no longer were permitted to make contributions to the Hewlett-Packard Company Employee Stock Purchase Plan (the "Legacy ESPP"). At October 31, 2004 and 2003, there were no remaining unvested shares in the Legacy ESPP. Compensation expense recognized under the Legacy ESPP was $29 million in fiscal 2002 for shares that HP matched on employee stock purchases.

Incentive Compensation Plans

HP has stock option plans, including principal plans adopted in 2000, 1995 and 1990, as well as various stock option plans assumed through acquisitions, under which stock options are outstanding. All regular employees were considered eligible to receive stock options in fiscal 2004. There were approximately 135,000 employees holding options under one or more of the option plans as of October 31, 2004. HP adopted an additional principal plan in fiscal 2004, under which no stock options have been granted. The principal plans adopted in 2004, 2000, 1995 and 1990 permit options granted to qualify as "incentive stock options" under the U.S. Internal Revenue Code. The exercise price of a stock option generally is equal to the fair market value of HP's common stock on the date the option is granted. The term of options granted in fiscal 2004 and 2003 was generally eight years, while options granted prior to fiscal 2003 generally had a ten-year term. Under the 2000 Stock Plan and the 1990 and 1995 Incentive Stock Plans, HP may choose, in certain cases, to establish a discounted exercise price at no less than 75% of fair market value on the grant date. HP did not grant any discounted options in fiscal 2004 and 2003. HP granted discounted options to purchase 679,000 shares in fiscal 2002. Options generally vest at a rate of 25% per year over a period of four years from the date of grant, with the exception of discounted options. Discounted options generally may not be exercised until the third or fifth anniversary of the option grant date, at which time such options become fully vested. The cost of the discounted options, determined to be the difference between the exercise price of the option and the fair market value of HP's common stock on the date of the option grant, is expensed ratably over the option vesting period.

Note 13: Stockholders' Equity (Continued)

Option activity was as follows for the fiscal years ended October 31:

	2004		2003		2002	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
			Shares in thousands			
Outstanding at beginning of year	499,858	$31	459,334	$32	217,441	$35
Granted	71,894	22	71,426	16	66,438	21
Assumed through acquisitions	2,507	14	—	—	202,028	33
Exercised	(12,869)	13	(14,873)	10	(9,208)	7
Forfeited or cancelled	(11,522)	30	(16,029)	33	(17,365)	37
Outstanding at end of year	549,868	30	499,858	31	459,334	32
Exercisable at end of year	377,438	$33	326,829	$34	286,830	$34

Information about options outstanding was as follows at October 31, 2004:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Shares Outstanding	Weighted-Average Remaining Contractual Life in Years	Weighted-Average Exercise Price	Shares Exercisable	Weighted-Average Exercise Price
		Shares in thousands			
$0-$9.99	2,967	4.4	$ 8	2,763	$ 9
$10-$19.99	130,697	5.6	$16	70,836	$16
$20-$29.99	210,854	5.8	$24	117,669	$25
$30-$39.99	85,037	4.6	$35	77,026	$35
$40-$49.99	68,641	4.4	$46	68,637	$46
$50-$59.99	33,633	4.6	$57	22,842	$56
$60 and over	18,039	4.0	$71	17,665	$71
	549,868	5.3	$30	377,438	$33

Under the 2000 Stock Plan and the 1990 and 1995 Incentive Stock Plans, certain employees were granted cash, restricted stock awards, or both. Cash and restricted stock awards are independent of option grants and are subject to restrictions. The majority of the shares of restricted stock outstanding at October 31, 2004 are subject to forfeiture if employment terminates prior to the release of restrictions, generally one to three years from the date of grant. During that period, ownership of the shares cannot be transferred. Restricted stock has the same cash dividend and voting rights as other common stock and is considered to be currently issued and outstanding. The cost of the awards, determined to be the fair market value of the shares at the date of grant, is expensed ratably over the period the restrictions lapse. HP had 1,533,000 shares of restricted stock outstanding at October 31, 2004, 1,008,000 shares of restricted stock outstanding at October 31, 2003 and 1,370,000 shares of restricted stock outstanding at October 31, 2002.

Note 13: Stockholders' Equity (Continued)

Compensation expense recognized under incentive compensation plans was approximately $48 million in fiscal 2004, $45 million in fiscal 2003 and $84 million in fiscal 2002.

Shares Reserved

Shares available for the ESPP and incentive compensation plans were 257,554,000 at October 31, 2004, including 29,123,000 shares under the assumed Compaq plans, and 168,951,000 at October 31, 2003, including 42,967,000 shares under the assumed Compaq plans.

HP had 808,855,000 shares of common stock reserved at October 31, 2004 and 670,929,000 shares of common stock reserved at October 31, 2003 for future issuance under stock-related benefit plans. Additionally, HP had 21,494,000 shares of common stock reserved at October 31, 2004 and 2003 for future issuances related to conversion of zero-coupon subordinated notes.

Stock Repurchase Program

HP repurchases shares of its common stock under a systematic program to manage the dilution created by shares issued under employee stock plans and also to return cash to HP's stockholders. This program authorizes purchases in the open market or in private transactions. During fiscal year 2004 HP's Board of Directors authorized $5.0 billion for future repurchases of outstanding common stock, including authorization to repurchase $3.0 billion of HP shares during the fourth quarter. HP completed share repurchases of approximately 172 million shares for $3.3 billion, 40 million shares for $751 million and 40 million shares for $671 million in fiscal 2004, 2003 and 2002, respectively. Shares repurchased in fiscal 2004 included open market repurchases of 66 million shares for $1.3 billion, 72 million shares for $1.3 billion under an accelerated share repurchase program with an investment bank (the "Accelerated Purchase") and 34 million shares for $679 million from the David and Lucile Packard Foundation (the "Packard Foundation"). Shares repurchased from the Packard Foundation in fiscal years 2003 and 2002 were 13 million shares and 3 million shares for $241 million and $31 million, respectively.

The Accelerated Purchase occurred on September 20, 2004 and was completed in November 2004, the first quarter of fiscal 2005. Upon completion of the program HP paid a $51 million price adjustment based on the difference between the $18.82 weighted average price of the open market stock purchases by the investment bank and the initial purchase price of $18.11 per share. The price adjustment also included certain amounts reflecting the investment bank's carrying costs or benefits from purchasing shares at prices other than the initial price and its benefits from receiving the $1.3 billion payment in advance of its purchases. The Accelerated Purchase was accounted for as an equity transaction on the cash settlement dates.

Shares repurchased from the Packard Foundation are purchased under the terms of a memorandum of understanding dated September 9, 2002 and amended and restated September 17, 2004 that, among other things, prices the repurchases by reference to the volume weighted-average price for composite New York Stock Exchange transactions on trading days in which a repurchase occurs. Either HP or the Packard Foundation may suspend or terminate sales under the amended and restated memorandum of understanding at any time.

As of October 31, 2004, HP had authorization for remaining future repurchases of approximately $2.9 billion.

Note 14: Comprehensive Income (Loss)

The changes in the components of other comprehensive income (loss), net of taxes, were as follows for the fiscal years ended October 31:

	2004	2003	2002
		In millions	
Net earnings (loss)	$3,497	$2,539	$ (903)
Net unrealized (losses) gains on available-for-sale securities:			
Change in net unrealized (losses) gains, net of tax benefit of $12 in 2004, taxes of $20 in 2003 and tax benefit of $4 in 2002	(12)	36	(7)
Net unrealized gains reclassified into earnings, net of taxes of $5 in 2004, $2 in 2003 and $1 in 2002	(8)	(3)	(2)
	(20)	33	(9)
Net unrealized (losses) gains on cash flow hedges:			
Change in net unrealized losses, net of tax benefits of $59 in 2004, $45 in 2003 and $19 in 2002	(100)	(77)	(41)
Net unrealized losses (gains) reclassified into earnings, net of tax benefits of $42 in 2004 and $17 in 2003 and taxes of $12 in 2002	72	29	(20)
	(28)	(48)	(61)
Net change in cumulative translation adjustment	21	2	7
Net change in additional minimum pension liability, net of tax benefit of $3 in 2004, taxes of $97 in 2003 and tax benefit of $191 in 2002	(13)	211	(379)
Comprehensive income (loss)	$3,457	$2,737	$(1,345)

The components of accumulated other comprehensive loss, net of taxes, were as follows at October 31:

	2004	2003
	In millions	
Net unrealized gains on available-for-sale securities	$ 23	$ 43
Net unrealized losses on cash flow hedges	(115)	(87)
Cumulative translation adjustment	30	9
Additional minimum pension liability	(181)	(168)
Accumulated other comprehensive loss	$(243)	$(203)

Note 15: Retirement and Post-Retirement Benefit Plans

Substantially all of HP's employees are covered under various defined benefit plans, defined contribution plans, or both, when they have met the eligibility requirements. In addition, HP sponsors medical and life insurance plans that provide benefits to retired U.S. employees who meet eligibility requirements.

Note 15: Retirement and Post-Retirement Benefit Plans (Continued)

Defined Benefit Plans

HP sponsors a number of defined benefit plans worldwide, of which the most significant are in the United States. For U.S employees hired or rehired on or after January 1, 2003, HP sponsors the Hewlett-Packard Company Cash Account Pension Plan (the "Cash Account Pension Plan"), a defined benefit plan under which benefits accrue pursuant to a cash accumulation account formula based upon a percentage of pay plus interest. The HP Retirement Plan (the "Retirement Plan") is a defined benefit pension plan for U.S. employees hired on or before December 31, 2002. Benefits under the Retirement Plan generally are based on pay and years of service, except for eligible pre-acquisition Compaq employees, who do not receive credit for years of service prior to January 1, 2003.

The benefit payable to a U.S. employee under the Retirement Plan for service before 1993, if any, is reduced by any amounts due to the employee under HP's frozen defined contribution Deferred Profit-Sharing Plan ("the DPSP"). The DPSP was closed to new participants in 1993. The DPSP plan obligations are equal to the plan assets and are recognized as an offset to the Retirement Plan when HP calculates its defined benefit pension cost and obligations. The fair value of plan assets and projected benefit obligations for the U.S. defined benefit plans combined with the DPSP as of the September 30 measurement date is as follows:

	2004		2003	
	Plan Assets	Projected Benefit Obligation	Plan Assets	Projected Benefit Obligation
	In millions			
U.S. defined benefit plans	$3,244	$4,970	$3,070	$4,408
DPSP	1,197	1,197	1,151	1,151
Total	$4,441	$6,167	$4,221	$5,559

Post-Retirement Benefit Plans

U.S. employees hired or rehired on or after January 1, 2003 may be eligible to participate in a post-retirement medical plan, the HP Retiree Medical Program, but must bear the full cost of their participation. In addition, substantially all of HP's U.S. employees at December 31, 2002 could become eligible for retiree life insurance benefits and partially subsidized retiree medical benefits under the Pre-2003 HP Retiree Medical Program (the "Pre-2003 Program") and certain other retiree medical programs. Plan participants in the Pre-2003 Program make contributions based on their choice of medical option and length of service.

The Medicare Act reduced HP's post-retirement medical plan obligations and expense during fiscal 2004. See Note 1 for a full description of the impact of the Medicare Act as adopted by HP in the third quarter of fiscal 2004, retroactive to December 2003, the date of the enactment of the Medicare Act.

Defined Contribution Plans

HP offers various defined contribution plans for U.S. and non-U.S. employees. Total defined contribution expense was $405 million in fiscal 2004, $377 million in fiscal 2003 and $309 million in fiscal 2002. U.S. employees are automatically enrolled in the Hewlett-Packard Company 401(k) Plan

Note 15: Retirement and Post-Retirement Benefit Plans (Continued)

(the “HP 401(k) Plan”) when they meet eligibility requirements unless they decline participation. On May 3, 2002, HP assumed the sponsorship of the Compaq Computer Corporation 401(k) Investment Plan (the “Compaq 401(k) Plan”). Effective January 1, 2004, the Compaq 401(k) Plan was merged into the HP 401(k) Plan.

U.S. employees may contribute up to 50% of eligible compensation on a pre-tax basis, subject to certain limits. Prior to January 1, 2003, the maximum employee contribution was 20% of eligible compensation. HP matches employee contributions with cash contributions up to a maximum of 4% of eligible compensation. During the last eight months of calendar 2002 for the Compaq 401(k) Plan only, HP matched up to a maximum of 6% of eligible compensation.

Effective January 31, 2004, the HP Stock Fund has been designated as an Employee Stock Ownership Plan and, as a result, participants in the HP Stock Fund may receive dividends in cash or may reinvest such dividends into the HP Stock Fund. HP paid approximately $13 million in dividends for the HP common shares held by the HP Stock Fund in fiscal 2004. The dividends are recorded as a reduction of retained earnings in the Consolidated Statements of Stockholders’ Equity. The HP Stock Fund held approximately 40 million shares of HP common stock at October 31, 2004.

Pension and Post-Retirement Benefit Expense

HP’s net pension and post-retirement benefit costs were as follows for the fiscal years ended October 31:

	U.S. Defined Benefit Plans			Non-U.S. Defined Benefit Plans			Post-Retirement Benefit Plans		
	2004	2003	2002	2004	2003	2002	2004	2003	2002
	In millions								
Service cost	$ 320	$ 284	$ 220	$ 213	$ 168	$ 108	$ 55	$ 46	$ 26
Interest cost	266	262	188	265	203	118	103	101	52
Expected return on plan assets	(247)	(215)	(174)	(346)	(217)	(157)	(30)	(25)	(34)
Amortization and deferrals:									
Actuarial loss (gain)	29	63	30	93	83	14	25	23	(6)
Prior service cost (benefit)	3	2	3	(2)	1	1	(9)	(2)	(4)
Net periodic benefit cost	371	396	267	223	238	84	144	143	34
Curtailment loss (gain)	—	—	1	—	(6)	(8)	—	—	70
Settlement loss (gain)	—	—	30	(3)	—	11	—	—	—
Special termination benefits	—	—	194	11	16	—	—	—	21
Net benefit cost	$ 371	$ 396	$ 492	$ 231	$ 248	$ 87	$ 144	$ 143	$ 125

Note 15: Retirement and Post-Retirement Benefit Plans (Continued)

The weighted average assumptions used to calculate net benefit cost were as follows for the fiscal years ended October 31:

	U.S. Defined Benefit Plans			Non-U.S. Defined Benefit Plans			Post-Retirement Benefit Plans		
	2004	2003	2002	2004	2003	2002	2004	2003	2002
Discount rate	6.5%	6.8%	7.0%	5.0%	5.2%	5.2%	6.5%	6.8%	7.0%
Average increase in compensation levels	4.0%	4.5%	5.8%	3.6%	4.0%	4.2%	—	—	—
Expected long-term return on assets	8.5%	8.5%	9.0%	6.9%	6.9%	7.5%	8.5%	8.5%	9.0%

The medical cost and related assumptions used to calculate the post-retirement benefit cost for the fiscal years ended October 31 were as follows:

	2004	2003	2002
Current medical cost trend rate	11.5%	12.5%	7.8%
Ultimate medical cost trend rate	5.5%	5.5%	5.5%
Year the medical cost rate reaches ultimate trend rate	2010	2010	2010

A 1.0 percentage point increase in the medical cost trend rate would have increased the fiscal 2004 service and interest components of the post-retirement benefit costs by $7 million, while a 1.0 percentage point decrease would have resulted in a decrease of $7 million in the same period.

Note 15: Retirement and Post-Retirement Benefit Plans (Continued)

Funded Status

The funded status of the defined benefit and post-retirement benefit plans was as follows at October 31:

	U.S. Defined Benefit Plans		Non-U.S. Defined Benefit Plans		Post-Retirement Benefit Plans	
	2004	2003	2004	2003	2004	2003
	In millions					
Change in fair value of plan assets:						
Fair value—beginning of year	$ 3,070	$ 2,351	$ 4,576	$ 2,774	$ 353	$ 317
Acquisition/addition/deletion of plans	3	—	70	400	—	—
Actual return on plan assets	376	460	407	351	43	56
Employer contributions	10	488	564	722	49	45
Participants' contributions	—	—	37	31	25	20
Benefits paid	(215)	(229)	(117)	(111)	(94)	(85)
Special termination benefits	—	—	(21)	—	—	—
Currency impact	—	—	408	409	—	—
Fair value—end of year	3,244	3,070	5,924	4,576	376	353
Change in benefit obligation:						
Benefit obligation—beginning of year	4,408	4,060	5,118	3,725	1,607	1,573
Acquisition/addition/deletion of plans	10	22	142	512	2	39
Service cost	320	284	213	168	55	46
Interest cost	266	262	265	203	103	101
Participants' contributions	—	—	37	31	25	20
Actuarial loss	181	9	223	110	109	124
Benefits paid	(215)	(229)	(117)	(111)	(94)	(85)
Plan amendments	—	—	(37)	(3)	52	(211)
Special termination benefits	—	—	(11)	4	—	—
Currency impact	—	—	451	479	2	—
Benefit obligation—end of year	4,970	4,408	6,284	5,118	1,861	1,607
Plan assets less than benefit obligation	(1,726)	(1,338)	(360)	(542)	(1,485)	(1,254)
Unrecognized net experience loss	540	516	1,445	1,277	568	496
Unrecognized prior service cost (benefit) related to plan changes	8	11	(44)	(8)	(56)	(116)
Net (accrued) prepaid amount recognized	(1,178)	(811)	1,041	727	(973)	(874)
Contributions after measurement date	—	—	6	16	3	3
Net amount recognized	$(1,178)	$ (811)	$ 1,047	$ 743	$ (970)	$ (871)
Accumulated benefit obligation	$ 3,882	$ 3,503	$ 5,425	$ 4,360		

Note 15: Retirement and Post-Retirement Benefit Plans (Continued)

The weighted average assumptions used to calculate the benefit obligation as of the measurement dates set forth in Note 1 were as follows:

	U.S. Defined Benefit Plans		Non-U.S. Defined Benefit Plans		Post-Retirement Benefit Plans	
	2004	2003	2004	2003	2004	2003
Discount rate	5.8%	6.5%	4.9%	5.0%	5.8%	6.5%
Average increase in compensation levels	4.0%	4.0%	3.7%	3.6%	—	—
Current medical cost trend rate	—	—	—	—	10.5%	11.5%
Ultimate medical cost trend rate	—	—	—	—	5.5%	5.5%
Year the rate reaches ultimate trend rate	—	—	—	—	2010	2010

A 1.0 percentage point increase in the medical cost trend rate would have increased the total post-retirement benefit obligation reported at October 31, 2004 by $73 million, while a 1.0 percentage point decrease would have resulted in a decrease of $71 million.

The net amount recognized for HP's defined benefit and post-retirement benefit plans was as follows at October 31:

	U.S. Defined Benefit Plans		Non-U.S. Defined Benefit Plans		Post-Retirement Benefit Plans	
	2004	2003	2004	2003	2004	2003
			In millions			
Prepaid benefit costs	$ —	$ —	$1,306	$1,155	$ —	$ —
Other accrued liabilities	(300)	—	—	—	—	—
Pension, post-retirement and post-employment liabilities	(1,152)	(1,073)	(269)	(428)	(973)	(874)
Accumulated other comprehensive loss	274	262	4	—	—	—
Contribution after measurement date	—	—	6	16	3	3
Net amount recognized	$(1,178)	$ (811)	$1,047	$ 743	$(970)	$(871)

Defined benefit plans with projected benefit obligations exceeding the fair value of plan assets were as follows:

	U.S. Defined Benefit Plans		Non-U.S. Defined Benefit Plans	
	2004	2003	2004	2003
		In millions		
Aggregate fair value of plan assets	$3,244	$3,070	$4,051	$3,323
Aggregate projected benefit obligation	$4,970	$4,408	$4,512	$3,945

Note 15: Retirement and Post-Retirement Benefit Plans (Continued)

Defined benefit plans with accumulated benefit obligations exceeding the fair value of plan assets were as follows:

	U.S. Defined Benefit Plans		Non-U.S. Defined Benefit Plans	
	2004	2003	2004	2003
	In millions			
Aggregate fair value of plan assets	$3,244	$1,973	$ 98	$260
Aggregate accumulated benefit obligation	$3,882	$2,469	$271	$574

Plan Asset Allocations

HP's weighted-average target and asset allocations at the September 30 measurement date were as follows:

	U. S. Defined Benefit Plans			Non-U.S. Defined Benefit Plans			Post-Retirement Benefit Plans		
	2004 Target Allocation	Plan Assets		2004 Target Allocation	Plan Assets		2004 Target Allocation	Plan Assets	
Asset Category		2004	2003		2004	2003		2004	2003
Equity securities		71.4%	71.1%		64.8%	63.8%		69.4%	70.1%
Private market securities		2.5%	2.4%		—	—		6.7%	6.4%
Real estate and other		0.3%	0.5%		3.7%	5.1%		0.8%	1.0%
Equity-related investments	74%	74.2%	74.0%	65%	68.5%	68.9%	77%	76.9%	77.5%
Public debt securities	26%	25.8%	26.0%	35%	31.5%	31.1%	23%	23.1%	22.5%
Total	100%	100.0%	100.0%	100%	100.0%	100.0%	100%	100.0%	100.0%

Investment Policy

HP's investment strategy for worldwide plan assets is to seek a competitive rate of return relative to an appropriate level of risk. The majority of the plans' investment managers employ active investment management strategies with the goal of outperforming the broad markets in which they invest. Risk management practices include diversification across asset classes and investment styles, and periodic rebalancing toward asset allocation targets. A number of the plans' investment managers are authorized to utilize derivatives for investment purposes, and HP occasionally utilizes derivatives to effect asset allocation changes or to hedge certain investment exposures.

The target asset allocation selected for each plan reflects a risk/return profile HP feels is appropriate relative to each plan's liability structure and return goals. HP regularly conducts periodic asset-liability studies for U.S. plan assets in order to model various potential asset allocations in comparison to each plan's forecasted liabilities and liquidity needs. A portion of the U.S. defined benefit plan assets and post-retirement benefit plan assets are invested in private market securities such as venture capital funds, private debt and private equity to provide diversification and higher expected returns.

Note 15: Retirement and Post-Retirement Benefit Plans (Continued)

Outside the U.S., local regulations require different approaches to target asset allocations, leaning toward a higher percentage allocation in fixed income securities. For each country the local pension board decides on the target allocation. HP's corporate office plays an important governance role in periodically reviewing and approving the allocation strategy and providing a recommended list of investment managers for each country plan.

Basis for Expected Long-Term Rate of Return on Plan Assets

The expected long-term rate of return on assets for each U.S. plan reflects the expected returns for each major asset class in which the plan invests, the weight of each asset class in the target mix, the correlations among asset classes, and their expected volatilities. Expected asset class returns reflected the current yield on U.S. government bonds and risk premiums for each asset class. HP considered factors such as historical risk premiums and current valuations, dividend yields, inflation and expected earnings growth rates. Because HP's investment policy is to employ primarily active investment managers who seek to outperform the broader market, the asset class expected returns were adjusted to reflect the expected additional returns net of fees.

The approach used to arrive at the expected rate of return on assets for the non-U.S. plans was to apply an asset allocation policy of each plan to the expected country real returns for equity and fixed income investments. On an annual basis, empirical data is gathered from the local country subsidiaries to determine expected long-term rates of return for equity and fixed income. These expected real rates of return are then weighted based on country specific allocation mixes adjusted for inflation.

Future Contributions and Funding Policy

HP expects to contribute approximately $850 million to its pension plans and $60 million to its post-retirement plans in fiscal 2005. HP's funding policy is to contribute cash to its pension plans so that at least the minimum contribution requirements, as established by local government and funding and taxing authorities, are met. Contributions made to the post-retirement plans will be used primarily for the payment of retiree health claims incurred during the fiscal year.

Estimated Future Benefits Payable

HP estimates that the future benefits payable for the retirement and post-retirement plans in place are as follows at October 31, 2004:

	U.S. Defined Benefit Plans	Non-U.S. Defined Benefit Plans	Post-Retirement Benefit Plans
		In millions	
Fiscal year ending October 31			
2005	$ 329	$ 133	$ 88
2006	$ 357	$ 129	$ 87
2007	$ 329	$ 147	$ 90
2008	$ 388	$ 155	$ 93
2009	$ 334	$ 173	$ 97
Next five fiscal years to October 31, 2014	$2,545	$1,115	$519

Note 16: Commitments

HP leases certain real and personal property under non-cancelable operating leases. Certain leases require HP to pay property taxes, insurance and routine maintenance, and include escalation clauses. Rent expense was approximately $766 million in fiscal 2004, $703 million in fiscal 2003 and $566 million in fiscal 2002. Sublease rental income was approximately $43 million in fiscal 2004, $46 million in fiscal 2003 and $17 million in fiscal 2002.

Future annual minimum lease payments and sublease rental income commitments, excluding future obligations included in the restructuring liabilities on the consolidated balance sheets, at October 31, 2004 are as follows:

	2005	2006	2007	2008	2009	Thereafter
			In millions			
Minimum lease payments	$521	$417	$342	$285	$256	$360
Less: Sublease rental income	(27)	(22)	(18)	(15)	(15)	(45)
	$494	$395	$324	$270	$241	$315

At October 31, 2004, HP had unconditional purchase obligations of approximately $1.0 billion. These unconditional purchase obligations include agreements to purchase goods or services that are enforceable and legally binding on HP and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. Purchase obligations exclude agreements that are cancelable without penalty. These unconditional purchase obligations are principally related to cost of sales, inventory and other items.

Note 17: Litigation and Contingencies

Pending Litigation and Proceedings

Intergraph Hardware Technologies Company v. HP, Dell & Gateway is a lawsuit filed in United States District Court for the Eastern District of Texas, Marshall County, on December 16, 2002. Gateway and Dell are no longer defendants in this matter. The suit accuses HP of infringement of three patents related to cache memory (the “Clipper Patents”). Intergraph Hardware Technologies Company (“Intergraph”) seeks damages constituting a “reasonable royalty” (as well as enhanced damages), an injunction, prejudgment interest, costs and attorneys’ fees. The complaint was served on HP on April 1, 2003. On May 21, 2003, HP answered and counterclaimed for a declaratory judgment that the patents are not infringed by HP and that the patents are invalid and unenforceable. Fact discovery closed on October 27, 2004. A claim construction hearing was held on May 7, 2004 and the court issued a ruling on the claim construction hearing on July 1, 2004. Jury selection is scheduled to begin on February 7, 2005, and trial is scheduled to begin on February 21, 2005. Expert discovery is ongoing. On May 7, 2004, Intergraph sued HP in United States District Court for the Eastern District of Texas, Tyler County, for infringement of another patent related to cache memory management. Intergraph seeks an injunction, declaratory relief and attorneys’ fees, but not damages. HP answered and counterclaimed, asserting Intergraph’s infringement of two HP software patents. HP seeks damages and an injunction. Trial in that matter is scheduled to begin on April 11, 2005 for Intergraph’s claims, and on October 24, 2005 for HP’s claims. Intergraph has obtained significant settlements from other defendants, ranging from $10 million (Advanced Micro Devices) to $300 million (Intel Corporation), relating to such defendants’ direct use of the Clipper Patents. However, the ultimate resolution of these proceedings

Note 17: Litigation and Contingencies (Continued)

and the financial impact on HP, which will depend in part on determinations as to the useful life of the patents, what would constitute "reasonable royalty" rates, the allocation of any amounts paid for accounting purposes, the timing of any payments and the units impacted, remains uncertain.

On May 28, 2003, HP sued Intergraph Corporation, the parent of Intergraph, in United States District Court for the Northern District of California, San Francisco Division, accusing Intergraph Corporation of infringement of four HP patents related to computer-aided design, video display technology and information retrieval technology. Intergraph answered and counterclaimed for declaratory relief on October 14, 2003. A claim construction hearing was held on October 22, 2004, and the court subsequently issued its claim construction rulings. HP expects trial to begin in mid-2005. HP seeks damages, an injunction, prejudgment interest, costs and attorneys' fees. On April 1, 2004, HP sued Intergraph Corporation in the Mannheim State Court in Mannheim, Germany, and related proceedings in Germany are pending, for infringement of two European Union patents related to computer-aided design. HP seeks damages, an injunction and costs. Trial took place in November 2004, and the court subsequently dismissed HP's action based on a determination of Intergraph's noninfringement. On April 19, 2004, HP sued Z/I Imaging, a subsidiary of Intergraph Corporation, and Intergraph Corporation, in United States District Court for the District of Delaware, accusing Z/I Imaging of infringement of two patents related to image scanning technology. Intergraph answered and counterclaimed for declaratory relief on May 28, 2004. Trial is scheduled to begin December 4, 2005. Also on April 19, 2004, HP sued Intergraph Corporation in United States District Court for the Eastern District of Texas for infringement of one patent relating to computer-aided design. Intergraph answered and counterclaimed for declaratory relief on May 13, 2004. Jury selection is expected to begin in December 2005. In both cases, HP seeks damages, an injunction, prejudgment interest, costs and attorneys' fees.

Copyright levies. Proceedings are being pursued against HP in certain European Union ("EU") member countries seeking to impose levies upon equipment (such as printers and multi-function devices) alleging that these devices enable producing private copies of copyrighted materials.

Two non-binding arbitration proceedings instituted in June 2001 and June 2002, respectively, were brought in Germany before the arbitration board of the Patent and Trademark Office. VerwertungsGesellschaft Wort ("VG Wort"), a collection agency representing certain copyright holders, brought the proceedings against HP, which relate to whether and to what extent copyright levies should be imposed in accordance with copyright laws implemented in Germany relating to multi-function devices and printers that allegedly enable the production of copies by private persons. The published tariffs on these devices in Germany range from 10 to 613.56 euros per unit. Non-binding proposals were presented in the proceedings, both of which HP rejected. In May 2004, VG Wort filed a lawsuit against HP in the Stuttgart Civil Court in Stuttgart, Germany seeking levies on multi-function devices ("MFDs"). A decision in this matter subsequently was issued. The court held that HP is liable for payments regarding photocopiers sold in Germany, but did not determine the exact amount payable per unit. The court further stated that HP should furnish information regarding the number of MFDs sold in Germany up to December 2001 and the number of copies per minute that various MFDs can produce. Finally, the court held that a levy of a maximum of 1.5% of the price was due on the bundle "LJ8150 MFP plus Scanner-Module C4166B," and that the individual elements of this bundle were not part of the claim. The deadline for filing an appeal of this decision is January 31, 2005. In July 2004, VG Wort filed a separate lawsuit against HP in the Stuttgart Civil Court seeking levies on printers. A decision in this matter was subsequently issued. The court held that HP is liable for payments regarding

Note 17: Litigation and Contingencies (Continued)

all printers using ASCII code sold in Germany, but did not determine the amount payable per unit. The court further stated that HP should furnish information regarding the number of printers sold in Germany since April 2001 and the number of copies per minute that various printers can produce. The deadline for filing an appeal of this decision is January 27, 2005. In September 2003, VG Wort filed a lawsuit against Fujitsu Siemens Computer GmbH ("FSC") in Munich State Court seeking levies on PCs. This is an industry test case in Germany, and HP has undertaken to be bound by a final decision. A decision in this matter subsequently was issued stating that PCs are subject to a levy and that FSC should furnish information as to the number of PCs sold in Germany since January 1, 2001. Further, FSC must pay 12 euros plus compound interest for each PC sold in Germany from March 24, 2001. FSC has indicated that it will appeal the decision.

In April 2001, the Organization for the Collective Management of Works of Literature, the Organization for the Collective Management of Works of Plastic Arts and their Applications, and the Organization for the Collective Management and Protection of Intellectual Property of Photographers brought five proceedings against HP Hellas and Compaq Computer E.P.E. in Greece relating to whether a levy of 2% should be payable upon computer products, including central processing units, monitors, keyboards, mice, diskettes, printers, scanners and related items in accordance with Greek copyright law, before its amendment in September 2002. These proceedings are pending before the Court of First Instance of Athens or before the Court of Appeal of Athens.

In April 1998, Auvibel s.c.r.l., a Belgian collection agency, filed an appeal of a judgment in HP's favor with the Court of Appeal in Brussels relating to a dispute as to whether and to what extent copyright levies should be imposed upon CD-writers and CD media. The case has been removed from the court's list of pending cases, without prejudice to the parties' right to reinstate the matter.

The total levies due, if imposed, would be based upon the number of products sold, and the per-product amounts of the levies, which will vary. Some EU member countries that do not yet have levies on digital devices are expected to implement similar legislation to enable them to extend existing levy schemes, while some other EU member countries are expected to limit the scope of levy schemes and applicability in the digital hardware environment. HP, other companies and various industry associations are opposing the extension of levies to the digital environment and advocating compensation to rights holders through digital rights management systems. Based on such opposition, HP's assessments of the merits of various proceedings and HP's estimates of the units impacted and levies, HP has accrued amounts that it believes are adequate to address the matters described above. However, the ultimate resolution of these matters, including the number of units impacted, the amount of levies imposed in various jurisdictions and the availability of HP to recover such amounts through increased prices, remains uncertain.

Alvis v. HP is a nationwide defective product consumer class action that was filed in state court in Jefferson County, Texas by a resident of Eastern Texas in April 2001. In February 2000, a similar suit captioned *LaPray v. Compaq* was filed in state court in Jefferson County, Texas. The basic allegation is that HP and Compaq sold computers containing floppy disk controllers that fail to alert the user to certain floppy disk controller errors. That failure is alleged to result in data loss or data corruption. The complaints in *Alvis* and *LaPray* seek injunctive relief, declaratory relief, unspecified damages and attorneys' fees. In July 2001, a nationwide class was certified in the *LaPray* case, which the Beaumont Court of Appeals affirmed in June 2002. In May 2004, the Texas Supreme Court reversed the certification of the nationwide class in the *LaPray* case and remanded the case to the trial court. The

Note 17: Litigation and Contingencies (Continued)

trial court has not set a new class certification hearing. A class certification hearing was held on July 1, 2003 in the *Alvis* case, and the court granted plaintiffs' motion to certify a nationwide class action. HP filed an appeal of that certification with the 9th Court of Appeals in Beaumont, Texas, which heard oral arguments on HP's appeal and received a supplemental briefing based upon the *LaPray* opinion from the Texas Supreme Court. On August 31, 2004, the 9th Court of Appeals in Texas reversed the lower court's decision certifying a nationwide class and remanded the case to the trial court. A class certification hearing was held, and the court has notified the parties that it will certify a Texas-wide class action for injunctive relief only. On June 4, 2003, *Barrett v. HP* and *Grider v. Compaq* were each filed in state court in Cleveland County, Oklahoma, with factual allegations similar to those in *Alvis* and *LaPray*. The complaints in *Barrett* and *Grider* seek, among other things, specific performance, declaratory relief, unspecified damages and attorneys' fees. On November 5, 2003, the court heard HP's motion to dismiss *Barrett v. HP* and *Grider v. Compaq*, which motion was subsequently denied. On December 22, 2003, the court entered an order staying both the *Barrett* and *Grider* cases until the conclusions of the *Alvis* and *LaPray* actions. On July 28, 2004, the Court lifted the stay in *Grider*, but took under advisement the plaintiff's motion to lift the stay in *Barrett*. On November 5, 2004, *Scott v. HP* was filed in state court in San Joaquin County, California, with factual allegations similar to those in *Alvis* and *LaPray*. The complaint in *Scott* seeks class certification, injunctive relief, unspecified damages (including punitive damages), restitution, costs and attorneys' fees. In addition, the Civil Division of the Department of Justice, the General Services Administration Office of Inspector General and other Federal agencies are conducting an investigation of allegations that HP and Compaq made or caused to be made false claims for payment to the United States for computers known by HP and Compaq to contain defective parts or otherwise to perform in a defective manner relating to the same alleged floppy disk controller errors. HP agreed with the Department of Justice to extend the statute of limitations on its investigation until June 6, 2005. HP is cooperating fully with this investigation.

On December 27, 2001, *Cornell University and the Cornell Research Foundation, Inc.* filed an action against HP in United States District Court for the Northern District of New York alleging that HP's PA-RISC 8000 family of microprocessors, and servers and workstations incorporating those processors, infringes a patent assigned to Cornell Research Foundation, Inc. that describes a way of executing microprocessor instructions. HP has answered and counterclaimed. This action seeks declaratory and injunctive relief and unspecified damages. On March 26, 2004, the court issued a ruling interpreting the disputed claims terms in the patent at issue. Discovery is ongoing, and no trial date has been set.

HP v. EMC Corporation ("EMC") is a lawsuit filed in United States District Court for the Northern District of California on September 30, 2002, in which HP accuses EMC of infringing seven HP patents. HP seeks damages, an injunction, prejudgment interest, costs and attorneys' fees. On July 21, 2003, EMC filed its answer and a cross-claim asserting, among other things, that numerous HP storage, server and printer products infringe six EMC patents. EMC seeks a permanent injunction as well as unspecified monetary damages, costs and attorneys' fees for patent infringement. The court issued an order construing disputed claim terms on June 23, 2004. Discovery is ongoing. Trial is expected in late 2005 or early 2006. Subsequently, HP filed a second lawsuit in United States District Court for the Northern District of California, in which HP accuses additional models of certain EMC products of infringing the same seven HP patents. HP seeks damages, an injunction, prejudgment interest, costs and attorneys' fees. EMC also filed suit against StorageApps, a company acquired by HP in fiscal 2001, in United States District Court in Worcester, Massachusetts on October 20, 2000. The suit accused StorageApps of infringement of EMC patents relating to storage devices, and sought a

Note 17: Litigation and Contingencies (Continued)

permanent injunction as well as unspecified monetary damages for patent infringement. The court held a hearing to construe the disputed claims terms of EMC's three patents in the suit on July 21-22, 2003 and issued its claim construction ruling on September 12, 2003. Following a trial in May 2004, the jury found that three of EMC's patents are valid and infringed. The damages phase of the litigation has commenced, and a trial on the issue of damages is scheduled to begin on February 17, 2005. HP is appealing the judgment of liability.

Neubauer, et al. v. Intel Corporation, Hewlett-Packard Company, et al. and *Neubauer, et al. v. Compaq Computer Corporation* are separate lawsuits filed on June 3, 2002 in state court in Madison County, Illinois, alleging that HP and Compaq (along with Intel) misled the public by suppressing and concealing the alleged material fact that systems that use the Intel Pentium 4 processor are less powerful and slower than systems using the Intel Pentium III processor and processors made by a competitor of Intel. The court in the HP action has certified an Illinois class as to Intel but denied a nationwide class. The plaintiffs seek unspecified damages, restitution, attorneys' fees and costs and certification of a nationwide class against HP and Compaq. The class action certification hearings against HP and Compaq have not been scheduled. In each action, HP and Compaq have filed motions to dismiss the cases, which the court has denied. HP and Compaq also have filed forum non conveniens motions, which are pending. *Skold, et al. v. Intel Corporation and Hewlett-Packard Company* is a lawsuit in state court in Alameda County, California to which HP was joined on June 14, 2004, based upon factual allegations similar to those in the *Neubauer* cases. The plaintiffs seek unspecified damages, restitution, attorneys' fees and cost and certification of nationwide class.

Forgent Networks v. HP et al. is a lawsuit filed on April 22, 2004 against HP as well as 30 other companies in United States District Court for the Eastern District of Texas. The complaint accuses HP of patent infringement with respect to HP's products that implement JPEG compression. JPEG is a standard for data compression used in HP's PCs, scanners, digital cameras, PDAs, and non-photo-printers. Forgent seeks unspecified damages, an injunction, interest, costs and attorneys' fees. Separately, HP has alerted government regulators of Forgent's participation in the JPEG standardization process and current licensing activities. Trial has been set for October 2005.

Hewlett-Packard Development Company, LP v. Gateway, Inc. is a lawsuit filed on March 24, 2004 by HP's wholly-owned subsidiary, Hewlett-Packard Development Company, LP ("HPDC"), against Gateway, Inc. in U.S. District Court in the Southern District of California, alleging infringement of six patents relating to various notebook, desktop and enterprise computer technologies. On April 2, 2004, HPDC filed an amended complaint, adding infringement allegations for four additional patents. HPDC seeks an injunction, unspecified monetary damages, interest and attorneys' fees. On May 10, 2004, Gateway filed an answer and a counterclaim, alleging infringement of five Gateway patents relating to computerized television, wireless, computer monitoring and computer expansion card technologies. Gateway seeks an injunction, unspecified monetary damages, interest and attorneys' fees. Claim construction is scheduled to begin on January 24-25, 2005. On May 6, 2004, HPDC and HP filed a complaint with the U.S. International Trade Commission ("ITC") against Gateway, alleging infringement of seven additional computer technology patents. HP seeks an injunction. On October 21, 2004, HPDC filed suit in the United States District Court for the Western District of Wisconsin against eMachines, a wholly-owned subsidiary of Gateway, alleging infringement of five HPDC patents relating to personal and desktop computers, of which three patents remain in suit. HPDC seeks an injunction, unspecified monetary damages, interest and attorneys' fees.

Note 17: Litigation and Contingencies (Continued)

On July 2, 2004, Gateway filed a complaint with the ITC against HP, alleging infringement of three patents relating to audio control, imaging and computerized television technologies. Gateway seeks an injunction. Also on July 2, 2004, Amiga Development LLC (''Amiga''), an entity affiliated with Gateway, filed a lawsuit against HP in the Eastern District of Texas, alleging infringement of three patents relating to computer monitoring, imaging and decoder technologies. Gateway seeks an injunction, unspecified monetary damages, interest and attorneys' fees. HP and HPDC have answered and counterclaimed, alleging infringement by Amiga and Gateway of four HPDC patents related to personal computer technology. On August 18, 2004, Gateway filed a declaratory relief action against HPDC in the United States District Court for the Southern District of California seeking a declaration of non-infringement and invalidity of the above-referenced four HPDC patents relating to personal computer technology. HPDC answered and counterclaimed and alleged infringement of the same four patents. HP seeks an injunction, unspecified monetary damages, interest and attorneys' fees. Claim construction is scheduled to begin in January 2005.

Hanrahan v. Hewlett-Packard Company and Carleton Fiorina is a lawsuit filed on November 3, 2003, in the United States District Court for the District of Connecticut on behalf of a putative class of persons who sold common stock of HP during the period from September 4, 2001 through November 5, 2001. The lawsuit seeks unspecified damages and generally alleges that HP and Ms. Fiorina violated the federal securities laws by making statements during this period which were misleading in failing to disclose that Walter B. Hewlett would oppose the proposed acquisition of Compaq by HP prior to Mr. Hewlett's disclosure of his opposition to the proposed transaction. A motion to transfer the action to federal court in California is pending, and no lead plaintiff has yet been appointed.

Stevens v. HP (renamed as *Erickson v. HP*) is an unfair business practices consumer class action filed in the Superior Court of California in Riverside County on July 31, 2000. Consumer class action lawsuits have been filed, in coordination with the original plaintiffs, in 33 additional jurisdictions. The various plaintiffs throughout the country claim to have purchased different models of HP inkjet printers. The basic factual allegation of these actions is that affected consumers who purchased HP printers received half-full or ''economy'' ink cartridges instead of full cartridges. Plaintiffs claim that HP's advertising, packaging and marketing representations for the printers led the consumers to believe they would receive full cartridges. These actions seek injunctive relief, disgorgement of profits, compensatory damages, punitive damages and attorneys' fees under various state unfair business practices statutes and common law claims of fraud and negligent misrepresentation. In the initial California matter, the court granted summary judgment in HP's favor and denied class certification. In October of 2003, the California appellate court affirmed the lower court's decisions and dismissed plaintiff's appeal. The matter was certified as a class action in North Carolina state court, where it was filed as *Hughes v. Hewlett-Packard Company*. HP prevailed at the trial of this case, which concluded in September 2003. The litigation is not in trial in other jurisdictions and the other cases have not been certified as class actions. Plaintiffs' counsel in all 33 jurisdictions have signed a dismissal agreement, which provides that all of the cases will be dismissed. Thus far twenty-one of the actions have been dismissed.

Digwamaje et al. v. Bank of America et al. is a purported class action lawsuit that names HP and numerous other multinational corporations as defendants. It was filed on September 27, 2002 in United States District Court for the Southern District of New York on behalf of current and former South

Note 17: Litigation and Contingencies (Continued)

African citizens and their survivors who suffered violence and oppression under the apartheid regime. The lawsuit alleges that HP and other companies helped perpetuate, and profited from, the apartheid regime during the period from 1948-1994 by selling products and services to agencies of the South African government. Claims are based on the Alien Tort Claims Act, the Torture Protection Act, the Racketeer Influenced and Corrupt Organizations Act and state law. The complaint seeks, among other things, an accounting, the creation of a historic commission, compensatory damages in excess of $200 billion, punitive damages in excess of $200 billion, costs and attorneys' fees. The court subsequently dismissed the plaintiffs' complaint, and plaintiffs have appealed the decision to the United States Court of Appeals for the Second Circuit.

In May 2002, the European Commission of the EU publicly stated that it was considering conducting an investigation into OEM activities concerning the sales of printers and supplies to consumers within the EU. The European Commission contacted HP requesting information on the printing systems businesses. HP is cooperating fully with this inquiry.

In March 2003, the Korea Fair Trade Commission commenced an investigation of the Korean printing and supplies market. The Korea Fair Trade Commission contacted HP requesting information on its printing systems business. A hearing is expected to be held in 2005. HP is cooperating fully with this inquiry.

The Government of Canada conducted cost audits of certain contracts between Public Works and Government Services Canada ("PWGSC") and each of Compaq Canada Corp. and Hewlett-Packard (Canada) Co. relating to services provided to the Canadian Department of National Defence ("DND"). Compaq Canada Corp. was combined with Hewlett-Packard (Canada) Co. following HP's acquisition of Compaq. HP cooperated fully with the audit and has conducted its own inquiry, sharing the results of its investigation with PWGSC and DND. On May 14, 2004, HP announced that it had resolved the dispute with the Government of Canada. HP Canada agreed to reimburse the Government of Canada the sum of CDN$146 million (approximately US$105 million), an amount determined by both parties to be appropriate upon investigation. HP recorded $70 million in the second quarter of fiscal 2004 and had recorded $35 million in the prior fiscal year. HP determined that it was important for HP to honor its contractual obligations, rather than engage in protracted litigation with the Government of Canada, despite the lack of evidence that HP employees derived any improper benefit from the complex scheme designed to exploit both parties. HP has initiated proceedings to recover these funds from responsible individuals, and continues to consider further proceedings against others to recover additional funds.

HP is involved in lawsuits, claims, investigations and proceedings, including those identified above, consisting of intellectual property, commercial, securities, employment, employee benefits and environmental matters, which arise in the ordinary course of business. In accordance with SFAS No. 5, "Accounting for Contingencies," HP makes a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. HP believes it has adequate provisions for any such matters. HP reviews these provisions at least quarterly and adjusts these provisions to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel, and other information and events pertaining to a particular case. Based on its experience, HP believes that any damage amounts claimed in the specific matters discussed above are not a meaningful indicator of HP's potential liability. Litigation is inherently unpredictable. However, HP believes that it has valid defenses with respect to legal matters pending against it. Nevertheless, it is possible that cash flows or

Note 17: Litigation and Contingencies (Continued)

results of operations could be materially affected in any particular period by the unfavorable resolution of one or more of these contingencies.

Environmental

HP is party to, or otherwise involved in, proceedings brought by United States or state environmental agencies under the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), known as "Superfund," or state laws similar to CERCLA. HP is also conducting environmental investigations or remediations at several current or former operating sites pursuant to administrative orders or consent agreements with state environmental agencies. It is our policy to apply strict standards for environmental protection to sites inside and outside the United States, even if not subject to regulations imposed by local governments. The liability for environmental remediation and other environmental costs is accrued when it is considered probable and the costs can be reasonably estimated. Historically, environmental costs have not been material to our operations or financial position.

Note 18: Segment Information

Description of Segments

HP is a leading global provider of products, technologies, solutions and services to individual consumers and businesses. HP's offerings span IT infrastructure and storage, personal computing and other access devices, multi-vendor services including maintenance, consulting and integration and outsourcing, and imaging and printing.

During fiscal 2004, HP organized its operations into seven business segments: PSG, IPG, ESS, HPS, HP Financial Services ("HPFS"), Software, and Corporate Investments. Given the cross-segment linkages in our Adaptive Enterprise offering, and in order to capitalize on up-selling and cross-selling opportunities, ESS, HPS and Software are structured beneath a broader Technology Solutions Group ("TSG"), in order to provide a supplementary view of HP's business. HP's organizational structure is based on a number of factors that management uses to evaluate, view and run its business operations which include, but are not limited to, customer base, homogeneity of products and technology. The business segments disclosed in the Consolidated Financial Statements are based on this organizational structure and information reviewed by HP's management to evaluate the business segment results. At the beginning of the first quarter of fiscal 2004, HP divided its Enterprise Systems Group into the ESS segment and Software segment. Segment operating results for fiscal 2003 and 2002 have been restated to reflect this organizational change as well as certain minor product reclassifications. Future changes to this organizational structure may result in changes to the business segments disclosed. A description of the types of products and services provided by each business segment follows.

Technology Solutions Group's mission is to coordinate HP's Adaptive Enterprise offering across organizations to create solutions that allow customers to manage and transform their business and IT environments. TSG allows HP to leverage the resources and capabilities of the HP portfolio by applying key design principles consistently across business, application and infrastructure services with a vision of standardization, simplification, modularity and integration. Each of the business segments within TSG is described in detail below.

Note 18: Segment Information (Continued)

- *Enterprise Storage and Servers* provides storage and server products. Business critical servers include Reduced Instruction Set Computing (RISC)-based servers running on the HP-UX operating system, Itanium®[(1)]-based servers running on HP-UX, Windows®[(2)] and Linux and the HP AlphaServer product line running on both Tru64 UNIX®[(3)] and Open VMS. The various server offerings range from low-end servers to high-end scalable servers, including the Superdome line. Additionally, HP offers its NonStop fault-tolerant server products for business critical solutions. Industry standard servers include primarily entry-level and mid-range ProLiant servers, which run primarily on the Windows, Linux and Novell operating systems, and HP's BladeSystem family of blade servers. HP's StorageWorks offerings include entry-level, mid-range and enterprise arrays, storage area networks (SANs), network attached storage, storage management software and virtualization technologies, as well as tape drives, tape libraries and optical archival storage.
- *HP Services* provides a portfolio of multi-vendor IT services including technology services, consulting and integration, and managed services. HPS also offers a variety of services tailored to particular industries such as manufacturing, network and service providers. In collaboration with ESS and Software, HPS teams with software and networking companies and local systems integrators to bring solutions to HP's customers. Technology services (formerly called Customer Support) provides a range of technology services from standalone product support to high availability services for complex, global, networked, multi-vendor environments. Technology services also manages the delivery of product warranty support through its own service organization, as well as through authorized resellers. Consulting and integration services help customers measure, assess and maintain the link between business and IT; design and integrate the customers' environments into a more adaptive infrastructure; and align, extend and manage applications and business processes. Consulting and integration provides cross-industry solutions in areas such as supply chain, business portals, messaging and security. Managed services offers IT management services, including comprehensive outsourcing, transformational infrastructure services, client computing managed services, managed web services, application services and business process outsourcing, as well as business continuity and recovery services.
- *Software* provides management software solutions, including support, that allow enterprise customers to manage their infrastructure, operations, applications and business processes under the HP OpenView brand. In addition, Software delivers a suite of comprehensive, carrier-grade platforms for developing and deploying next-generation voice, data and converged services to network and service providers under the HP OpenCall brand.
- *Personal Systems Group* provides commercial PCs, consumer PCs, workstations, handheld computing devices, digital entertainment systems, calculators and other related accessories, software and services for commercial and consumer markets. Commercial PCs are optimized for commercial uses, including enterprise and small and medium business customers, and for connectivity and manageability in networked environments. Commercial PCs include the HP business desktops and the HP Compaq business series, Evo notebook PCs and Compaq Tablet

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(1) Itanium® is a registered trademark of Intel Corporation.

(2) Windows® is a registered trademark of Microsoft Corporation.

(3) UNIX® is a registered trademark of The Open Group.

Note 18: Segment Information (Continued)

PCs. Consumer PCs are targeted at the home user and include the HP Pavilion and Compaq Presario series of multi-media consumer desktop PCs and notebook PCs, as well as HP Media Center PCs. Workstations are individual computing products designed for users demanding enhanced performance, such as computer animation, engineering design and other programs requiring high resolution graphics. Workstations are provided for UNIX, Windows and Linux-based systems. Handheld computing devices include the iPAQ series of products ranging from entry-level devices primarily used as organizers to advanced devices with biometric security and wireless capability, that run on Windows Mobile software. Digital entertainment products include DVD+RW drives, the HP Movie Writer, the HP Digital Entertainment Center, plasma and LCD flat panel televisions and the Apple iPod®[4] from HP.

- *Imaging and Printing Group* provides home and business printing, imaging and publishing devices and systems, digital imaging products and printer supplies. Home and business printing, imaging and publishing devices and systems include color and monochrome single-function printers for shared and personal use, printer- and copier-based multi-function devices, inkjet and laser all-in-one printers, wide- and large-format inkjet printers and digital presses. Digital imaging products include Photosmart printers, digital photography products and scanners. Printer supplies include laser and inkjet printer cartridges and other related printing media such as HP-branded Vivera ink and HP Premium and Premium Plus photo papers.
- *HP Financial Services* supports and enhances HP's global product and services solutions, providing a broad range of value-added financial life cycle management services. HPFS enables HP's worldwide customers to acquire complete IT solutions, including hardware, software and services. HPFS offers leasing, financing, utility programs, and asset recovery services, as well as financial asset management services, for large global and enterprise customers. HPFS also provides an array of specialized financial services to small and medium-sized businesses and education and government entities. HPFS offers innovative, customized and flexible alternatives to balance unique customer cash flow, technology obsolescence and capacity needs.
- *Corporate Investments* is managed by the Office of Strategy and Technology and includes HP Labs and certain business incubation projects. Revenue in this segment is attributable to the sale of certain network infrastructure products that enhance computing and enterprise solutions as well as the licensing of specific HP technology to third parties.

Segment Data

The results of the business segments are derived directly from HP's internal management reporting system. The accounting policies used to derive business segment results are substantially the same as those used by the consolidated company. Management measures the performance of each business segment based on several metrics, including earnings from operations. These results are used, in part, to evaluate the performance of, and to assign resources to, each of the business segments. Certain operating expenses, which HP manages separately at the corporate level, are not allocated to the business segments. These unallocated costs include primarily amortization of purchased intangible assets, certain acquisition-related charges and charges for purchased IPR&D as well as certain corporate governance costs.

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(4) iPod® is a registered trademark of Apple Computer, Inc.

Note 18: Segment Information (Continued)

Restructuring charges and any associated adjustments thereto related to restructuring actions initiated prior to fiscal 2004 are not allocated to the business segments.

Selected operating results information for each business segment, as well as for TSG, was as follows for the fiscal years ended October 31:

	Total Net Revenue			Earnings (Loss) from Operations		
	2004	2003	2002	2004	2003	2002
	In millions					
Enterprise Storage and Servers	$15,152	$14,593	$10,402	$ 173	$ 142	$ (308)
HP Services	13,778	12,357	9,052	1,263	1,362	891
Software	922	774	703	(145)	(190)	(348)
Technology Solutions Group	29,852	27,724	20,157	1,291	1,314	235
Personal Systems Group	24,622	21,210	14,680	210	22	(236)
Imaging and Printing Group	24,199	22,569	20,358	3,847	3,596	3,365
HP Financial Services	1,895	1,921	1,707	125	79	(134)
Corporate Investments	449	344	288	(178)	(161)	(232)
Segment total	$81,017	$73,768	$57,190	$5,295	$4,850	$2,998

The reconciliation of segment operating results information to HP consolidated totals was as follows for the fiscal years ended October 31:

	2004	2003	2002
		In millions	
Net revenue:			
Segment total	$81,017	$73,768	$57,190
Elimination of intersegment net revenue and other	(1,112)	(707)	(602)
Total HP consolidated	$79,905	$73,061	$56,588
Earnings (loss) before taxes:			
Total segment earnings from operations	$ 5,295	$ 4,850	$ 2,998
Acquisition-related inventory write-downs	—	—	(147)
Corporate and unallocated costs and eliminations	(260)	(310)	(187)
Restructuring charges	(114)	(800)	(1,780)
In-process research and development charges	(37)	(1)	(793)
Acquisition-related charges	(54)	(280)	(701)
Amortization of purchased intangible assets	(603)	(563)	(402)
Interest and other, net	35	21	52
Gains (losses) on investments and early extinguishment of debt	4	(29)	(75)
Dispute settlement	(70)	—	14
Total HP consolidated	$ 4,196	$ 2,888	$ (1,021)

Assets are allocated to the business segments based on the primary segments benefiting from the assets. Certain assets, such as deferred tax assets, which cannot be directly attributable to a segment,

Note 18: Segment Information (Continued)

are allocated based on certain drivers. Corporate and unallocated assets are composed primarily of cash and cash equivalents and short-term investments. As described above, fiscal 2004 segment asset information is stated based on the 2004 organizational structure. However, it is not practicable to restate fiscal 2003 and 2002 segment assets for these changes. Total assets by segment as well as for TSG and the reconciliation of segment assets to HP consolidated total assets was as follows at October 31:

	2004	2003	2002
		In millions	
Enterprise Storage and Servers	$13,856	$ —	$ —
Software	1,422	—	—
Enterprise Systems Group	15,278	15,038	15,555
HP Services	14,619	12,700	12,436
Technology Solutions Group	$29,897	$27,738	$27,991
Personal Systems Group	10,622	10,421	9,986
Imaging and Printing Group	14,169	13,824	12,272
HP Financial Services	7,992	7,830	8,540
Corporate Investments	375	228	129
Corporate and unallocated assets	13,083	14,675	11,792
Total HP consolidated assets	$76,138	$74,716	$70,710

Major Customers

No single customer represented 10% or more of HP's total net revenue in any fiscal year presented.

Geographic Information

Net revenue, classified by the major geographic areas in which HP operates, was as follows for the fiscal years ended October 31:

	2004	2003	2002
		In millions	
Net revenue:			
U.S.	$29,362	$29,218	$23,302
Non-U.S.	50,543	43,843	33,286
Total net revenue	$79,905	$73,061	$56,588

Net revenue by geographic area is based upon the sales location which predominately represents the customer location. No single country outside of the United States represented more than 10% of HP's total net revenue in any period presented. No single country outside of the United States represented 10% or more of HP's total net assets in any period presented, with the exception of the Netherlands at October 31, 2004 and Belgium at October 31, 2003, respectively. No single country outside of the United States represented more than 10% of HP's total net property, plant and

Note 18: Segment Information (Continued)

equipment in any period presented. HP's long-lived assets other than goodwill and purchased intangible assets, which are not allocated to specific geographic locations as it is impracticable to do so, are composed principally of net property, plant and equipment.

Net property, plant and equipment, classified by major geographic areas in which HP operates, was as follows at October 31:

	2004	2003	2002
		In millions	
Net property, plant and equipment:			
U.S.	$2,648	$3,693	$4,158
Non-U.S.	4,001	2,789	2,766
Total net property, plant and equipment	$6,649	$6,482	$6,924

Net revenue by similar products or services

Net revenue from products or services in each of the Software, HPFS* and Corporate Investments segments are similar. The following table provides net revenue for similar classes of products within the IPG, PSG, ESS and HPS segments for the fiscal years ended October 31:

	2004	2003	2002
		In millions	
Printer hardware	$ 9,440*	$ 9,086*	$ 8,661*
Supplies	13,197*	12,004*	10,453*
Digital imaging and other	1,562	1,479	1,244
Imaging and Printing Group	$24,199	$22,569	$20,358
Desktop personal computers	$14,168*	$12,503*	$ 9,293*
Notebook personal computers	8,422*	6,922	4,050
Workstations	1,018	923	763
Personal appliances and other	1,014	862	574
Personal Systems Group	$24,622	$21,210	$14,680
Servers	$11,884*	$11,095*	$ 7,626*
Storage	3,268	3,498	2,776
Enterprise Storage and Servers	$15,152	$14,593	$10,402
Technology services	$ 8,673*	$ 8,018*	$ 5,850*
Managed services	2,590	1,873	1,073
Consulting and integration	2,515	2,466	2,129
HP Services	$13,778	$12,357	$ 9,052

* Denotes that net revenue for the class of products or services equaled or exceeded 10% of HP's consolidated net revenue for the fiscal year or, in the case of HPFS, for all fiscal years presented.

HEWLETT-PACKARD COMPANY AND SUBSIDIARIES
Quarterly Summary
(Unaudited)

	Three-month periods ended			
	January 31	April 30	July 31	October 31
	In millions, except per share amounts			
2004				
Net revenue	$19,514	$20,113	$18,889	$21,389
Cost of sales[(1)]	14,564	15,045	14,443	16,288
Research and development	875	910	862	859
Selling, general and administrative	2,719	2,816	2,738	2,751
Amortization of purchased intangible assets	144	148	146	165
Restructuring charges	54	38	9	13
Acquisition-related charges	15	9	6	24
In-process research and development charges	—	9	28	—
Total costs and expenses	18,371	18,975	18,232	20,100
Earnings from operations	1,143	1,138	657	1,289
Interest and other, net	11	2	20	2
Gains (losses) on investments	9	(5)	1	(1)
Dispute settlement	—	(70)	—	—
Earnings before taxes	1,163	1,065	678	1,290
Provision for taxes	227	181	92	199
Net earnings	936	884	586	1,091
Net earnings per share:[(2)]				
Basic	$ 0.31	$ 0.29	$ 0.19	$ 0.37
Diluted	$ 0.30	$ 0.29	$ 0.19	$ 0.37
Cash dividends paid per share	$ 0.08	$ 0.08	$ 0.08	$ 0.08
Range of per share closing stock prices on the New York Stock Exchange and Nasdaq Stock Market:				
Low	$ 21.28	$ 19.70	$ 19.50	$ 16.50
High	$ 26.12	$ 24.12	$ 22.00	$ 20.50
2003[(3)]				
Net revenue	$17,877	$17,983	$17,348	$19,853
Cost of sales[(1)]	13,141	13,103	12,810	14,804
Research and development	908	941	895	907
Selling, general and administrative	2,725	2,795	2,785	2,707
Amortization of purchased intangible assets	138	141	141	143
Restructuring charges	—	234	376	190
Acquisition-related charges	86	126	40	28
In-process research and development charges	—	—	—	1
Total costs and expenses	16,998	17,340	17,047	18,780
Earnings from operations	879	643	301	1,073
Interest and other, net	51	(20)	10	(20)
Gains (losses) on investments	(5)	(12)	(24)	12
Earnings before taxes	925	611	287	1,065
Provision for (benefit from) taxes	204	(48)	(10)	203
Net earnings	721	659	297	862
Net earnings per share:[(2)]				
Basic	$ 0.24	$ 0.22	$ 0.10	$ 0.28
Diluted	$ 0.24	$ 0.22	$ 0.10	$ 0.28
Cash dividends paid per share	$ 0.08	$ 0.08	$ 0.08	$ 0.08
Range of per share closing stock prices on the New York Stock Exchange and Nasdaq Stock Market:				
Low	$ 14.85	$ 15.00	$ 16.55	$ 19.26
High	$ 20.85	$ 18.44	$ 23.52	$ 22.31

(1) Cost of products, cost of services and financing interest.

(2) EPS for each quarter is computed using the weighted-average number of shares outstanding during that quarter, while EPS for the fiscal year is computed using the weighted-average number of shares outstanding during the year. Thus, the sum of the EPS for each of the four quarters may not equal the EPS for the fiscal year.

(3) Certain reclassifications have been made in order to conform to the fiscal 2004 presentation.