HP INC
Form 10-Q
September 01, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q
(Mark One)

ý	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the quarterly period ended: July 31, 2016
Or

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

For the transition period from to
Commission file number 1-4423

HP INC.
(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.)
1501 Page Mill Road, Palo Alto, California	94304
(Address of principal executive offices)	(Zip code)

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

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 (the "Exchange Act") 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 ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ý	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes o No ý

The number of shares of HP common stock outstanding as of July 31, 2016 was 1,710,875,682 shares

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HP INC. AND SUBSIDIARIES
Form 10-Q
For the Quarterly Period ended July 31, 2016

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In this report on Form 10-Q, for all periods presented, "we", "us", "our", "company", "HP" and "HP Inc." refer to HP Inc. (formerly Hewlett-Packard Company) and its consolidated subsidiaries.

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Forward-Looking Statements

This Quarterly Report on Form 10-Q, including "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 2 of Part I, contains forward-looking statements that involve risks, uncertainties and assumptions. If the risks or uncertainties ever materialize or the assumptions prove incorrect, the results of HP Inc. and its consolidated subsidiaries ("HP") may differ materially from those expressed or implied by such forward-looking statements and assumptions. All statements other than statements of historical fact are statements that could be deemed forward-looking statements, including but not limited to any projections of net revenue, margins, expenses, effective tax rates, net earnings, net earnings per share, cash flows, benefit plan funding, deferred tax assets, share repurchases, currency exchange rates or other financial items; any projections of the amount, timing or impact of cost savings or restructuring and other charges; any statements of the plans, strategies and objectives of management for future operations, including the execution of restructuring plans and any resulting cost savings, revenue or profitability improvements; any statements concerning the expected development, performance, market share or competitive performance relating to products or services; any statements regarding current or future macroeconomic trends or events and the impact of those trends and events on HP and its financial performance; any statements regarding pending investigations, claims or disputes; any statements of expectation or belief; and any statements of assumptions underlying any of the foregoing. Risks, uncertainties and assumptions include the need to address the many challenges facing HP's businesses; the competitive pressures faced by HP's businesses; risks associated with executing HP's strategy; the impact of macroeconomic and geopolitical trends and events; the need to manage third-party suppliers and the distribution of HP's products and the delivery of HP's services effectively; the protection of HP's intellectual property assets, including intellectual property licensed from third parties; risks associated with HP's international operations; the development and transition of new products and services and the enhancement of existing products and services to meet customer needs and respond to emerging technological trends; the execution and performance of contracts by HP and its suppliers, customers, clients and partners; the hiring and retention of key employees; integration and other risks associated with business combination and investment transactions; the results of the restructuring plans, including estimates and assumptions related to the cost (including any possible disruption of HP's business) and the anticipated benefits of the restructuring plans; the resolution of pending investigations, claims and disputes; and other risks that are described herein, including but not limited to, those discussed in this Quarterly Report on Form 10-Q, and in particular, the risks discussed in Part I, Item 1A "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended October 31, 2015 and in our Quarterly Reports on Form 10-Q for the fiscal quarters ended January 31, 2016 and April 30, 2016, and that are otherwise described or updated from time to time in HP's other filings with the Securities and Exchange Commission (the "SEC"). HP assumes no obligation and does not intend to update these forward-looking statements.

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Part I. Financial Information

ITEM 1. Financial Statements and Supplementary Data.
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HP INC. AND SUBSIDIARIES
Consolidated Condensed Statements of Earnings
(Unaudited)

	Three months ended July 31		Nine months ended July 31	
	2016	2015	2016	2015
	In millions, except per share amounts			
Net revenue	$11,892	$12,362	$35,726	$39,197
Costs and expenses:				
Cost of revenue	9,720	10,036	29,019	31,624
Research and development	298	300	891	909
Selling, general and administrative	719	1,058	2,758	3,508
Restructuring and other charges	36	1	156	22
Amortization of intangible assets	2	24	16	76
Defined benefit plan settlement credits	—	(64)	—	(64)
Total costs and expenses	10,775	11,355	32,840	36,075
Earnings from continuing operations	1,117	1,007	2,886	3,122
Interest and other, net	(36)	(90)	(135)	(289)
Earnings from continuing operations before taxes	1,081	917	2,751	2,833
Provision for taxes	(238)	(217)	(598)	(630)
Net earnings from continuing operations	843	700	2,153	2,203
Net (loss) earnings from discontinued operations	(60)	154	(149)	1,028
Net earnings	$783	$854	$2,004	$3,231
Net earnings (loss) per share:				
Basic				
Continuing operations	$0.49	$0.39	$1.24	$1.21
Discontinued operations	(0.03)	0.08	(0.08)	0.57
Total basic net earnings per share	$0.46	$0.47	$1.16	$1.78
Diluted				
Continuing operations	$0.49	$0.39	$1.23	$1.20
Discontinued operations	(0.04)	0.08	(0.08)	0.55
Total diluted net earnings per share	$0.45	$0.47	$1.15	$1.75
Cash dividends declared per share	$0.25	$0.35	$0.50	$0.67
Weighted-average shares used to compute net earnings per share:				
Basic	1,711	1,805	1,735	1,817
Diluted	1,725	1,828	1,747	1,842

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

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HP INC. AND SUBSIDIARIES
Consolidated Condensed Statements of Comprehensive Income
(Unaudited)

	Three months ended July 31		Nine months ended July 31	
	2016	2015	2016	2015
	In millions			
Net earnings	$783	$854	$2,004	$3,231
Other comprehensive income before taxes:				
Change in unrealized gains (losses) on available-for-sale securities:				
Unrealized gains (losses) arising during the period	1	4	2	(9)
Change in unrealized components of cash flow hedges:				
Unrealized gains arising during the period	175	292	135	905
Losses (gains) reclassified into earnings	159	(159)	63	(1,049)
	334	133	198	(144)
Change in unrealized components of defined benefit plans:				
Losses arising during the period	—	(75)	(4)	(75)
Amortization of actuarial loss and prior service benefit	12	108	36	324
Settlements and other	—	97	1	99
	12	130	33	348
Change in cumulative translation adjustment	—	(44)	—	(112)
Other comprehensive income before taxes	347	223	233	83
(Provision for) benefit from taxes	(28)	(69)	41	(50)
Other comprehensive income, net of taxes	319	154	274	33
Comprehensive income	$1,102	$1,008	$2,278	$3,264

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

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HP INC. AND SUBSIDIARIES
Consolidated Condensed Balance Sheets
(Unaudited)

	As of July 31, 2016	October 31, 2015
	In millions, except par value	
ASSETS		
Current assets:		
Cash and cash equivalents	$5,636	$7,584
Accounts receivable	4,008	4,825
Inventory	3,961	4,288
Other current assets	3,797	4,498
Current assets of discontinued operations	—	30,592
Total current assets	17,402	51,787
Property, plant and equipment	1,607	1,492
Goodwill	5,618	5,680
Other non-current assets	2,597	1,592
Non-current assets of discontinued operations	—	46,331
Total assets	$27,224	$106,882
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Notes payable and short-term borrowings	$75	$2,194
Accounts payable	10,402	10,194
Employee compensation and benefits	712	747
Taxes on earnings	162	243
Deferred revenue	877	1,051
Other accrued liabilities	5,886	6,241
Current liabilities of discontinued operations	—	21,521
Total current liabilities	18,114	42,191
Long-term debt	6,760	6,677
Other non-current liabilities	6,276	7,414
Non-current liabilities of discontinued operations	—	22,449
Commitments and contingencies		
Stockholders' equity:		
HP stockholders' (deficit) equity		
Preferred stock, $0.01 par value (300 shares authorized; none issued)	—	—
Common stock, $0.01 par value (9,600 shares authorized; 1,711 and 1,804 shares issued and outstanding at July 31, 2016 and October 31, 2015, respectively)	17	18
Additional paid in capital	986	1,963
Retained earnings (deficit)	(3,982)	32,089
Accumulated other comprehensive loss	(947)	(6,302)
Total HP stockholders' (deficit) equity	(3,926)	27,768
Non-controlling interests of discontinued operations	—	383
Total stockholders' (deficit) equity	(3,926)	28,151
Total liabilities and stockholders' equity	$27,224	$106,882

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

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HP INC. AND SUBSIDIARIES
Consolidated Condensed Statements of Cash Flows
(Unaudited)

	Nine months ended July 31	
	2016	2015
	In millions	
Cash flows from operating activities:		
Net earnings	$2,004	$3,231
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	249	3,054
Stock-based compensation expense	140	476
Provision for doubtful accounts	37	38
Provision for inventory	76	227
Restructuring and other charges	151	426
Deferred taxes on earnings	978	898
Excess tax benefit from stock-based compensation	(4)	(124)
Other, net	(408)	675
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	728	1,199
Financing receivables	—	192
Inventory	251	(467)
Accounts payable	238	(358)
Taxes on earnings	(877)	(1,075)
Restructuring and other	(114)	(1,006)
Other assets and liabilities	(917)	(3,505)
Net cash provided by operating activities	2,532	3,881
Cash flows from investing activities:		
Investment in property, plant and equipment	(287)	(2,642)
Proceeds from sale of property, plant and equipment	—	310
Purchases of available-for-sale securities and other investments	(122)	(180)
Maturities and sales of available-for-sale securities and other investments	133	246
Payment made in connection with business acquisitions, net of cash acquired	—	(2,617)
Proceeds from business divestitures, net	160	156
Net cash used in investing activities	(116)	(4,727)
Cash flows from financing activities:		
Short-term borrowings with original maturities less than 90 days, net	72	2,633
Proceeds from debt, net of issuance costs	4	5,993
Payment of debt	(2,158)	(2,642)
Settlement of cash flow hedges	4	(32)
Net transfer of cash and cash equivalents to Hewlett Packard Enterprise Company	(10,375)	—
Issuance of common stock under employee stock plans	41	303
Repurchase of common stock	(1,159)	(2,582)
Excess tax benefit from stock-based compensation	4	124
Cash dividends paid	(646)	(913)
Net cash (used in) provided by financing activities	(14,213)	2,884
Net (decrease) increase in cash and cash equivalents	(11,797)	2,038
Cash and cash equivalents at beginning of period	17,433	15,133
Cash and cash equivalents at end of period	$5,636	$17,171

Supplemental schedule of non-cash investing and financing activities:		
Net assets transferred to Hewlett Packard Enterprise Company	$22,144	$—
Purchase of assets under capital leases	$118	$70
Stock awards assumed in business acquisitions	$—	$31

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

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HP INC. AND SUBSIDIARIES
Notes to Consolidated Condensed Financial Statements
(Unaudited)

Note 1: Overview and Basis of Presentation

Overview

On November 1, 2015 (the "Distribution Date"), Hewlett-Packard Company completed the separation of Hewlett Packard Enterprise Company ("Hewlett Packard Enterprise"), Hewlett-Packard Company's former enterprise technology infrastructure, software, services and financing businesses (the "Separation"). In connection with the Separation, Hewlett-Packard Company changed its name to HP Inc. ("HP").

On the Distribution Date, each of HP's stockholders of record as of the close of business on October 21, 2015 (the "Record Date") received one share of Hewlett Packard Enterprise common stock for every one share of HP common stock held as of the Record Date. Hewlett Packard Enterprise is now an independent public company trading on the New York Stock Exchange ("NYSE") under the symbol "HPE". HP distributed a total of approximately 1.8 billion shares of Hewlett Packard Enterprise common stock to HP's stockholders. After the Separation, HP does not beneficially own any shares of Hewlett Packard Enterprise common stock.

In connection with the Separation, HP and Hewlett Packard Enterprise entered into a separation and distribution agreement as well as various other agreements that provide a framework for the relationships between the parties, including among others a tax matters agreement, an employee matters agreement, a transition service agreement, a real estate matters agreement, a master commercial agreement and an information technology service agreement. For more information on the impacts of these agreements, see Note 5, "Retirement and Post-Retirement Benefit Plans", Note 6, "Stock-Based Compensation", Note 7, "Taxes on Earnings", Note 14, "Litigation and Contingencies" and Note 15, "Guarantees, Indemnifications and Warranties".

Basis of Presentation

The accompanying Consolidated Condensed Financial Statements of HP and its wholly-owned subsidiaries are prepared in conformity with United States ("U.S.") generally accepted accounting principles ("GAAP"). The interim financial information is unaudited, but reflects all normal adjustments that are necessary to provide a fair statement of results for the interim periods presented. This interim information should be read in conjunction with the Consolidated Financial Statements for the fiscal year ended October 31, 2015 in the Annual Report on Form 10-K filed on December 16, 2015 and in the Current Report on Form 8-K filed on April 27, 2016. The Consolidated Condensed Balance Sheet for October 31, 2015 was derived from audited financial statements.

After the Separation, HP no longer consolidates the financial results of Hewlett Packard Enterprise within its financial results of continuing operations. For all the periods prior to the Separation, the financial results of Hewlett Packard Enterprise are presented as net earnings from discontinued operations in the Consolidated Condensed Statements of Earnings and assets and liabilities from discontinued operations in the Consolidated Condensed Balance Sheets. Fiscal 2015 information in the accompanying Notes to the Consolidated Condensed Financial Statements have been revised to reflect the effect of the Separation, except for balances related to stockholders' (deficit) equity. The historical statements of comprehensive income and cash flows have not been revised to reflect the effect of the Separation. For further information on discontinued operations, see Note 2, "Discontinued Operations".

Principles of Consolidation

The Consolidated Condensed Financial Statements include the accounts of HP and its subsidiaries and affiliates in which HP has a controlling financial interest or is the primary beneficiary. HP presents non-controlling interests as a separate component within Total stockholders' (deficit) equity in the Consolidated Condensed Balance Sheets. All intercompany balances and transactions have been eliminated.

Use of Estimates

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

Accounting Pronouncements

In June 2016, the Financial Accounting Standards Board ("FASB") issued guidance which requires credit losses on financial assets measured at amortized cost basis to be presented at the net amount expected to be collected, not based on incurred losses. Further, credit losses on available-for-sale debt securities should be recorded through an allowance for credit losses limited to the amount by which fair value is below amortized cost. HP is required to adopt the guidance in the first quarter of fiscal 2021. Earlier adoption is permitted. HP is currently evaluating the impact of this guidance on its Consolidated Condensed Financial Statements.

In March 2016, the FASB issued guidance which amends the existing accounting standards for share-based payments. The amendment changes the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statements of cash flows. HP is required to adopt the guidance in the first quarter of fiscal 2018. Earlier adoption is permitted. HP is currently evaluating the timing and the impact of this guidance on its Consolidated Condensed Financial Statements.

In February 2016, the FASB issued guidance which amends the existing accounting standards for leases. Consistent with current guidance, the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification. Under the new guidance, a lessee will be required to recognize assets and liabilities for all leases with lease terms of more than twelve months. HP is required to adopt the guidance in the first quarter of fiscal 2020 using a modified retrospective approach. HP is currently evaluating the timing and the impact of this guidance on its Consolidated Condensed Financial Statements.

In January 2016, the FASB issued guidance which amends the existing accounting standards for the recognition and measurement of financial assets and financial liabilities. The updated guidance primarily addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. HP is required to adopt the guidance in the first quarter of fiscal 2019. The amendments should be applied by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption, with other amendments related specifically to equity securities without readily determinable fair values applied prospectively. HP is currently evaluating the timing and the impact of this guidance on its Consolidated Condensed Financial Statements.

In April 2015, the FASB amended the existing accounting standards for intangible assets. The amendment provides explicit guidance to customers in determining the accounting for fees paid in a cloud computing arrangement, wherein the arrangements that do not convey a software license to the customer are accounted for as service contracts. HP is required to adopt the guidance in the first quarter of fiscal 2017; however early adoption is permitted. The amendment may be adopted either prospectively to all arrangements entered into or materially modified after the effective date or retrospectively. HP is currently evaluating the impact of this guidance on its Consolidated Condensed Financial Statements.

In April 2015, the FASB amended the existing accounting standards for imputation of interest. The amendment requires that debt issuance costs related to a recognized debt liability be presented on the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by this amendment. HP is required to adopt the guidance in the first quarter of fiscal 2017. Early adoption is permitted. The amendment should be applied retrospectively with the adjusted balance sheet of each individual period presented, in order to reflect the period-specific effects of applying the new guidance. HP is currently evaluating the timing and the impact of this guidance on its Consolidated Condensed Financial Statements.

In May 2014, the FASB amended the existing accounting standards for revenue recognition. The amendment is based on the principle that revenue should be recognized to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued an accounting standard update for a one-year deferral of the effective date, with an option of applying the standard on the original effective date, which for HP is the first quarter of fiscal 2018.

In accordance with this deferral, HP is required to adopt these amendments in the first quarter of fiscal 2019. The amendments may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of initial application. HP is continuing to evaluate the impact of this guidance and the transition alternatives on its Consolidated Condensed Financial Statements.

HP INC. AND SUBSIDIARIES
Notes to Consolidated Condensed Financial Statements
(Unaudited)

Note 2: Discontinued Operations

On November 1, 2015, HP completed the Separation of Hewlett Packard Enterprise. After the Separation, HP does not beneficially own any shares of Hewlett Packard Enterprise common stock.

In connection with the Separation, HP and Hewlett Packard Enterprise have entered into a separation and distribution agreement as well as various other agreements that provide a framework for the relationships between the parties, including among others a tax matters agreement, an employee matters agreement, a transition service agreement, a real estate matters agreement, a master commercial agreement and an information technology service agreement. These agreements provided for the allocation between HP and Hewlett Packard Enterprise of assets, employees, liabilities and obligations (including investments, property, employee benefits and tax-related assets and liabilities) attributable to periods prior to, at and after the Separation and govern certain relationships between HP and Hewlett Packard Enterprise after the Separation.

After the Separation, HP no longer consolidates the financial results of Hewlett Packard Enterprise within its financial results of continuing operations. For all the periods prior to the Separation, the financial results of Hewlett Packard Enterprise are presented as net earnings from discontinued operations in the Consolidated Condensed Statements of Earnings and assets and liabilities from discontinued operations in the Consolidated Condensed Balance Sheets. For all the periods after the Separation, discontinued operations includes separation costs primarily related to third-party consulting, contractor fees and other costs.

The following table presents the financial results of HP's discontinued operations:

	Three months ended July 31		Nine months ended July 31	
	2016	2015	2016	2015
	In millions, except per share amounts			
Net revenue	$—	$12,987	$—	$38,444
Cost of revenue[1]	—	9,281	—	27,609
Expenses[2]	30	3,501	158	9,394
Interest and other, net[3][4]	(174)	18	(157)	132
Earnings (loss) from discontinued operations before taxes	144	187	(1)	1,309
Provision for taxes[4]	(204)	(33)	(148)	(281)
(Loss) earnings from discontinued operations, net of taxes	$(60)	$154	$(149)	$1,028

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

(2) Expenses for the three and nine months ended July 31, 2016 were primarily related to separation costs.

(3) In fiscal 2015, allocation of interest to Hewlett Packard Enterprise was based on the average effective interest rate of the debt assumed by Hewlett Packard Enterprise and the debt repaid as part of the Separation.

(4) In connection with the tax matters agreement (the "TMA"), Interest and other, net for the three and nine months ended July 31, 2016 includes $174 million and $157 million, respectively, of net tax indemnification amounts and Provision for taxes for the three and nine months ended July 31, 2016 includes $172 million and $156 million, respectively, of the tax impact relating to the above amounts. For more information on tax indemnifications and the TMA, see Note 7, "Taxes on Earnings".

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HP INC. AND SUBSIDIARIES
Notes to Consolidated Condensed Financial Statements
(Unaudited)
Note 2: Discontinued Operations (Continued)

There were no significant non-cash items or any capital expenditures of discontinued operations for the three and nine months ended July 31, 2016. For the three and nine months ended July 31, 2015, significant non-cash items and capital expenditures of discontinued operations are outlined below:

	Three months ended July 31, 2015	Nine months ended July 31, 2015
	In millions	
Depreciation and amortization	$925	$2,750
Purchases of property, plant and equipment	$768	$2,215

The following table presents assets and liabilities that were transferred to Hewlett Packard Enterprise as of November 1, 2015 and presented as discontinued operations in the Consolidated Condensed Balance Sheets as of October 31, 2015:

	In millions
Cash and cash equivalents	$9,849
Accounts receivable	8,538
Financing receivables	2,918
Inventory	2,197
Other current assets	7,090
Total current assets of discontinued operations	$30,592
Property, plant and equipment	$9,598
Goodwill	27,261
Long-term financing receivables and other non-current assets	9,472
Total non-current assets of discontinued operations	$46,331
Notes payable and short-term borrowings	$691
Accounts payable	5,762
Employee compensation and benefits	2,861
Taxes on earnings	587
Deferred revenue	5,148
Other accrued liabilities	6,472
Total current liabilities of discontinued operations	$21,521
Long-term debt	$15,103
Other non-current liabilities	7,346
Total non-current liabilities of discontinued operations	$22,449

Subsequent to the Separation, HP made a final net cash transfer of $526 million to Hewlett Packard Enterprise.

Note 3: Segment Information

HP is a leading global provider of personal computing and other access devices, imaging and printing products, and related technologies, solutions and services. HP sells to individual consumers, small- and medium-sized businesses ("SMBs") and large enterprises, including customers in the government, health and education sectors.

HP's operations are organized into three segments for financial reporting purposes: Personal Systems, Printing and Corporate Investments. HP's organizational structure is based on a number of factors that the chief operating decision maker uses to evaluate, view and run its business operations, which include, but are not limited to, customer base and homogeneity of products and technology. The segments are based on this organizational structure and information reviewed by HP's chief operating decision maker to evaluate segment results. The chief operating decision maker uses several metrics to evaluate the

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HP INC. AND SUBSIDIARIES
Notes to Consolidated Condensed Financial Statements
(Unaudited)
Note 3: Segment Information (Continued)

performance of the overall business, including earnings from operations, and uses these results to allocate resources to each of the segments.

A summary description of each segment is as follows:

Personal Systems provides commercial personal computers ("PCs"), consumer PCs, workstations, thin clients, tablets, retail point-of-sale systems, calculators and other related accessories, software, support and services for the commercial and consumer markets. HP groups commercial notebooks, commercial desktops, commercial services, commercial tablets, commercial detachables, workstations, retail point-of-sale systems and thin clients into commercial clients and consumer notebooks, consumer desktops, consumer services, consumer tablets and consumer detachables into consumer clients when describing performance in these markets. Described below are HP's global business capabilities within Personal Systems.

- Commercial PCs are optimized for enterprise and SMB customers, with a focus on robust designs, security, serviceability, connectivity, reliability and manageability in networked environments. Additionally, HP offers a range of services and solutions to enterprise and SMB customers to help them manage the lifecycle of their PC and mobility installed base.
- Consumer PCs are notebooks, desktops, and hybrids that are optimized for consumer usage, focusing on multi-media consumption, online browsing, and light productivity.

Printing provides consumer and commercial printer hardware, supplies, media, solutions and services, as well as scanning devices. Printing is also focused on imaging solutions in the commercial markets. HP groups LaserJet, graphics and PageWide printers into Commercial Hardware and Inkjet printers into Consumer Hardware when describing performance in these markets. Described below are HP's global business capabilities within Printing.

- LaserJet and Enterprise Solutions delivers HP's LaserJet printers, supplies and solutions to SMBs and large enterprises. HP goes to market through its extensive channel network and directly with HP sales. Ongoing key initiatives include design and deployment of A3 products and solutions for the copier and multifunction printer market, printer security solutions, PageWide Enterprise solutions, and award-winning JetIntelligence products.
- Inkjet and Printing Solutions delivers HP's consumer, SMB, and PageWide Inkjet solutions (hardware, supplies, media, and web-connected hardware and services). Ongoing initiatives and programs such as Instant Ink and newer initiatives such as Continuous Ink Supply System provide innovative printing solutions to consumers and SMBs.
- Graphics Solutions delivers large format printers (DesignJet, Large Format Production, and Scitex Industrial), specialty printing, digital press solutions (Indigo and PageWide Presses), supplies and services to print service providers and design and rendering customers.
- Print Solutions provides end-to-end services, as well as core platforms to develop and deploy services across printing systems. HP's focus includes driving customer value through managed print services and providing support solutions for new and existing customers.

Corporate Investments include HP Labs and certain business incubation projects, among others.

The accounting policies used to derive segment results are substantially the same as those used by the Company in preparing the financial statements. HP derives the results of the business segments directly from its internal management reporting system. Segment net revenue includes revenues from sales to external customers and intersegment revenues that reflect transactions between the segments on an arm's-length basis. HP's consolidated net revenue is derived and reported after the elimination of intersegment revenues from such arrangements.

HP does not allocate certain operating expenses, which it manages at the corporate level, to its segments. These unallocated costs include certain corporate costs, stock-based compensation expense, restructuring charges, amortization of intangible assets, defined benefit plan settlement credits, non-operating retirement-related credits and intersegment eliminations.

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HP INC. AND SUBSIDIARIES
Notes to Consolidated Condensed Financial Statements
(Unaudited)
Note 3: Segment Information (Continued)

Segment Reporting Changes
Effective at the beginning of its first quarter of fiscal 2016, HP implemented a reporting change to provide better transparency to its segment operating results. This reporting change resulted in the exclusion of certain market-related factors such as interest cost, expected return on plan assets, amortized actuarial gains or losses, and impacts from other market-related factors related to its defined benefit pension and post-retirement benefit plans from its segment operating results ("Non-operating retirement-related credits/(charges)"). This change also resulted in the exclusion of certain plan curtailments, settlements and special termination benefits related to its defined benefit pension and post-retirement benefit plans from HP's segment operating results. Segment operating results will continue to include service costs and amortization of prior service costs associated with HP's defined benefit pension and post-retirement benefit plans. The reporting change had an immaterial impact to previously reported segment net revenue and earnings from operations and had no impact on HP's previously reported consolidated net revenue, earnings from operations, net earnings or net earnings per share ("EPS").
Segment Operating Results from Continuing Operations:

	Personal Systems	Printing	Corporate Investments	Total Segments	Intersegment Eliminations and Other[1]	Total
	In millions					
Three months ended July 31, 2016						
Net revenue	$7,512	$4,423	$ —	$ 11,935	$ (43)	$11,892
Earnings (loss) from operations	$333	$903	$ (35)	$ 1,201		
Three months ended July 31, 2015						
Net revenue	$7,505	$5,163	$ 2	$ 12,670	$ (308)	$12,362
Earnings (loss) from operations	$211	$896	$ (12)	$ 1,095		
Nine months ended July 31, 2016						
Net revenue	$21,969	$13,702	$ 6	$ 35,677	$ 49	$35,726
Earnings (loss) from operations	$804	$2,491	$ (66)	$ 3,229		
Nine months ended July 31, 2015						
Net revenue	$23,826	$16,267	$ 16	$ 40,109	$ (912)	$39,197
Earnings (loss) from operations	$741	$2,928	$ (32)	$ 3,637		

(1) Other includes adjustments for sales to entities which, prior to the Separation, were included in intersegment eliminations. For the nine months ended July 31, 2016, the amount also includes the recognition of revenue previously deferred in relation to sales to the pre-Separation finance entity. For the nine months ended July 31, 2015, the amount also includes the elimination of intercompany sales to the pre-Separation finance entity, which is included in discontinued operations. The related cost adjustments are reflected in the reconciliation of the segment earnings to HP's consolidated earnings as included below.

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Note 3: Segment Information (Continued)

The reconciliation of segment operating results to HP consolidated results was as follows:

	Three months ended July 31		Nine months ended July 31	
	2016	2015	2016	2015
	In millions			
Net Revenue:				
Total segments	$11,935	$12,670	$35,677	$40,109
Intersegment net revenue eliminations and other	(43)	(308)	49	(912)
Total net revenue	$11,892	$12,362	$35,726	$39,197
Earnings from continuing operations before taxes:				
Total segment earnings from operations	$1,201	$1,095	$3,229	$3,637
Corporate costs and eliminations	(45)	(126)	(149)	(486)
Stock-based compensation expense	(39)	(58)	(140)	(168)
Restructuring and other charges	(36)	(1)	(156)	(22)
Amortization of intangible assets	(2)	(24)	(16)	(76)
Acquisition-related charges	—	(1)	—	(1)
Defined benefit plan settlement credits	—	64	—	64
Non-operating retirement-related credits	38	58	118	174
Interest and other, net	(36)	(90)	(135)	(289)
Total earnings from continuing operations before taxes	$1,081	$917	$2,751	$2,833

Net revenue by segment and business unit was as follows:

	Three months ended July 31		Nine months ended July 31	
	2016	2015	2016	2015
	In millions			
Notebooks	$4,303	$3,993	$12,346	$12,887
Desktops	2,455	2,700	7,384	8,411
Workstations	476	507	1,381	1,546
Other	278	305	858	982
Personal Systems	7,512	7,505	21,969	23,826
Supplies	2,840	3,455	9,040	10,740
Commercial Hardware	1,290	1,330	3,736	4,100
Consumer Hardware	293	378	926	1,427
Printing	4,423	5,163	13,702	16,267
Corporate Investments	—	2	6	16
Total segment net revenue	11,935	12,670	35,677	40,109
Intersegment net revenue eliminations and other	(43)	(308)	49	(912)
Total net revenue	$11,892	$12,362	$35,726	$39,197

There have been no material changes to the total assets of HP's individual segments since October 31, 2015.

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Note 4: Restructuring and Other Charges
Fiscal 2015 Plan
In connection with the Separation, on September 14, 2015, HP's Board of Directors approved a cost savings plan which includes labor and non-labor actions which will be implemented through fiscal 2016. HP estimates that it will incur aggregate pre-tax charges up to $300 million which relate to workforce reductions, real estate consolidation and other non-labor charges. HP expects approximately 3,000 employees will exit by the end of fiscal 2016.
During the nine months ended July 31, 2016, HP announced a voluntary phased retirement program ("PRP") for certain qualified employees. Qualified employees will retire gradually over a defined period of time and at the end of which they will receive severance and certain benefits. HP recognized charges aggregating $29 million during the nine months ended July 31, 2016 related to the PRP.
The following table summarizes the cost saving plan activities in the three and nine months ended July 31, 2016.

			Nine months ended July 31, 2016				As of July 31, 2016	
In millions	Accrued Balance, October 31, 2015	Three months ended July 31, 2016 Charges	Charges	Cash Payments	Non-Cash and Other Adjustments	Accrued Balance [1], July 31, 2016	Total Costs Incurred to Date	Total Expected Costs to Be Incurred
Fiscal 2015 Plan								
Severance and PRP	$ 39	$ 20	$107	$ (83)	$ (12)	$ 51	$145	$ 240
Infrastructure and other [1]	—	8	27	(3)	(19)	5	27	60
Total	$ 39	$ 28	$134	$ (86)	$ (31)	$ 56	$172	$ 300

(1) Accrued expenses related to the Fiscal 2015 Plan are included in Other accrued liabilities on the Consolidated Condensed Balance Sheets.

Fiscal 2012 Plan
The severance and infrastructure cash payments associated with the restructuring plan (the "2012 Plan") initiated by HP in fiscal 2012 are expected to be paid through fiscal 2021. For the three and nine months ended July 31, 2016, HP recognized $3 million and $5 million, respectively, in total severance charges in connection with the 2012 Plan. Accrued expenses related to the 2012 Plan, which were included in Other accrued liabilities and Other non-current liabilities on the Consolidated Condensed Balance Sheets, totaled $10 million as of July 31, 2016.
Other charges

Other charges include non-recurring costs that are distinct from ongoing operational costs. The charges include information technology costs incurred in connection with the Separation. HP incurred $5 million and $17 million of other charges for the three and nine months ended July 31, 2016, respectively.

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Note 5: Retirement and Post-Retirement Benefit Plans
The components of HP's pension and post-retirement benefit (credit) cost recognized in the Consolidated Condensed Statements of Earnings were as follows:

	Three months ended July 31					
	U.S. Defined Benefit Plans		Non-U.S. Defined Benefit Plans		Post-Retirement Benefit Plans	
	2016	2015	2016	2015	2016	2015
	In millions					
Service cost	$—	$—	$12	$64	$—	$1
Interest cost	136	140	6	92	5	7
Expected return on plan assets	(183)	(210)	(12)	(195)	(8)	(10)
Amortization and deferrals:						
Actuarial loss (gain)	14	12	6	73	(3)	(2)
Prior service benefit	—	—	(1)	(4)	(4)	(5)
Net periodic benefit (credit) cost	(33)	(58)	11	30	(10)	(9)
Settlement gain	—	(72)	—	—	—	—
Special termination benefits	—	—	—	—	—	1
Plan credit allocation[(1)]	—	—	—	—	—	(8)
Total periodic benefit (credit) cost from continuing operations	(33)	(130)	11	30	(10)	(16)
Summary of total periodic benefit (credit) cost:						
Continuing operations	(33)	(130)	11	30	(10)	(16)
Discontinued operations	—	183	—	26	—	8
Total periodic benefit (credit) cost	$(33)	$53	$11	$56	$(10)	$(8)

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Note 5: Retirement and Post-Retirement Benefit Plans (Continued)

	Nine months ended July 31					
	U.S. Defined Benefit Plans		Non-U.S. Defined Benefit Plans		Post-Retirement Benefit Plans	
	2016	2015	2016	2015	2016	2015
	In millions					
Service cost	$—	$—	$35	$195	$—	$3
Interest cost	408	418	18	280	15	21
Expected return on plan assets	(549)	(644)	(36)	(590)	(24)	(28)
Amortization and deferrals:						
Actuarial loss (gain)	42	37	18	220	(9)	(8)
Prior service benefit	—	—	(3)	(14)	(12)	(15)
Net periodic benefit (credit) cost	(99)	(189)	32	91	(30)	(27)
Settlement loss (gain)	1	(72)	1	2	—	—
Special termination benefits	—	—	—	8	9	1
Plan credit allocation[1]	—	—	—	(11)	—	(24)
Total periodic benefit (credit) cost from continuing operations	(98)	(261)	33	90	(21)	(50)
Summary of total periodic benefit (credit) cost:						
Continuing operations	(98)	(261)	33	90	(21)	(50)
Discontinued operations	—	193	—	79	—	24
Total periodic benefit (credit) cost	$(98)	$(68)	$33	$169	$(21)	$(26)

(1) Plan credit allocation relates to the employees of HP covered under Hewlett Packard Enterprise plans or employees of Hewlett Packard Enterprise covered under HP plans.

Employer Contributions and Funding Policy

HP's policy is to fund its pension plans so that it makes at least the minimum contribution required by local government, funding and taxing authorities.

During the nine months ended July 31, 2016, HP contributed $15 million to its non-U.S. pension plans, paid $24 million to cover benefit payments to U.S. non-qualified plan participants, and paid $24 million to cover benefit claims under HP's post-retirement benefit plans. During the remainder of fiscal 2016, HP anticipates making additional contributions of approximately $3 million to its non-U.S. pension plans and approximately $9 million to its U.S. non-qualified plan participants and expects to pay approximately $11 million to cover benefit claims under HP's post-retirement benefit plans.

HP's pension and other post-retirement benefit costs and obligations depend on various assumptions. Differences between expected and actual returns on investments and changes in discount rates and other actuarial assumptions are reflected as unrecognized gains or losses, and such gains or losses are amortized to earnings in future periods. A deterioration in the funded status of a plan could result in a need for additional company contributions or an increase in net pension and post-retirement benefit costs in future periods. Actuarial gains or losses are determined at the measurement date and amortized over the remaining service life for active plans or the life expectancy of plan participants for frozen plans.

Lump Sum Program

During the third quarter of fiscal 2016, HP offered a program whereby certain terminated vested participants of the HP Inc. Pension Plan ("Pension Plan") could elect to take a one-time voluntary lump sum payment equal to the present value of future benefits. This program closed on July 29, 2016. Approximately 17,000 plan participants elected to receive lump sum

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Note 5: Retirement and Post-Retirement Benefit Plans (Continued)

payments which they will receive from plan assets in the fourth quarter of fiscal 2016. Settlement expense will be recorded in the fourth quarter of fiscal 2016.

In January 2015, HP offered certain terminated vested participants of the Pension Plan the option of receiving their pension benefit in a one-time voluntary lump sum during a specified window. As a result of the lump sum program, HP recognized a settlement credit of approximately $72 million in the third quarter of fiscal 2015. As a result of the settlement, additional net periodic benefit cost of $8 million was recorded in the third quarter of fiscal 2015, which offset the actuarial gain from the settlement and was recognized in the Consolidated Condensed Statements of Earnings as Defined benefit plan settlement credits.

Note 6: Stock-Based Compensation
HP's stock-based compensation plans permit the issuance of restricted stock awards, stock options and performance-based awards.
Stock-based compensation expense and the resulting tax benefits from continuing operations were as follows:

	Three months ended July 31		Nine months ended July 31	
	2016	2015	2016	2015
	In millions			
Stock-based compensation expense[(1)]	$39	$58	$140	$168
Income tax benefit	(13)	(17)	(48)	(49)
Stock-based compensation expense, net of tax	$26	$41	$92	$119

(1) In connection with the Separation and in accordance with the employee matters agreement, HP has made certain adjustments to the exercise price and number of stock-based compensation awards with the intention of preserving the intrinsic value of the awards prior to the Separation. The pre-tax stock-based compensation expense due to the adjustments was $2 million and was recorded during the three months ended January 31, 2016. All outstanding restricted stock awards and stock options for employees transferred to Hewlett Packard Enterprise were cancelled (the "Cancelled Awards") in connection with the Separation.

Restricted Stock Awards
Restricted stock awards are non-vested stock awards that may include grants of restricted stock or restricted stock units. For the three and nine months ended July 31, 2016 and 2015, HP granted only restricted stock units. HP uses the closing stock price on the grant date to estimate the fair value of service-based restricted stock units. HP estimates the fair value of restricted stock units subject to performance-adjusted vesting conditions using a combination of the closing stock price on the grant date and the Monte Carlo simulation model. For the three months ended July 31, 2016 and 2015, HP did not grant any restricted stock units subject to performance-adjusted vesting conditions. The weighted-average fair value and the assumptions used to measure fair value of restricted stock units subject to performance-adjusted vesting conditions in the Monte Carlo simulation model were as follows:

	Nine months ended July 31	
	2016	2015
Weighted-average fair value[(1)]	$13	$47

Expected volatility[2]	32.5%	33.6%
Risk-free interest rate[3]	1.2 %	1.0 %
Expected performance period in years[4]	2.9	2.9

(1) The weighted-average fair value was based on performance-adjusted restricted stock units granted during the period.

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Note 6: Stock Based Compensation (Continued)

(2) The expected volatility was estimated using the historical volatility derived from HP's common stock.

(3) The risk-free interest rate was estimated based on the yield on U.S. Treasury zero-coupon issues.

(4) The expected performance period was estimated based on the length of the remaining performance period from the grant date.

A summary of restricted stock award activity was as follows:

	Nine months ended July 31, 2016	
	Shares	Weighted-Average Grant Date Fair Value Per Share
	In thousands	
Outstanding at beginning of period	29,717	$ 32
Granted	27,968	$ 9
Vested	(3,219)	$ 13
Cancelled Awards	(23,926)	$ 32
Forfeited	(1,751)	$ 13
Outstanding at end of period	28,789	$ 13

At July 31, 2016, there was $201 million of unrecognized pre-tax stock-based compensation expense related to non-vested restricted stock awards, which HP expects to recognize over the remaining weighted-average vesting period of 1.4 years.

Stock Options

HP utilizes the Black-Scholes-Merton option pricing formula to estimate the fair value of stock options subject to service-based vesting conditions. HP estimates the fair value of stock options subject to performance-contingent vesting conditions using a combination of a Monte Carlo simulation model and a lattice model, as these awards contain market conditions. The weighted-average fair value and the assumptions used to measure fair value were as follows:

	Three months ended July 31		Nine months ended July 31	
	2016	2015	2016	2015
Weighted-average fair value(1)	$2	$6	$4	$8
Expected volatility(2)	31.6%	26.7%	36.2%	26.3%
Risk-free interest rate(3)	1.3%	1.6%	1.8%	1.7%
Expected dividend yield(4)	4.3%	2.3%	3.5%	1.8%
Expected term in years(5)	5.5	5.2	6.0	5.8

(1) The weighted-average fair value was based on stock options granted during the period.

(2) For all awards granted in fiscal 2016, expected volatility was estimated using the leverage-adjusted average of the term-matching volatilities of peer companies due to the lack of volume of forward traded options, which precluded

the use of implied volatility. For all awards granted in fiscal 2015, expected volatility was estimated using the implied volatility derived from options traded on HP's common stock.

(3) The risk-free interest rate was estimated based on the yield on U.S. Treasury zero-coupon issues.

(4) The expected dividend yield represents a constant dividend yield applied for the duration of the expected term of the award.

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Note 6: Stock Based Compensation (Continued)

(5) For awards subject to service-based vesting, due to the lack of historical exercise and post-vesting termination patterns of the post-Separation employee base, the expected term was estimated using a simplified method for all awards granted in fiscal 2016 and the expected term was estimated using historical exercise and post-vesting termination patterns for all awards granted in fiscal 2015; and for performance-contingent awards, the expected term represents an output from the lattice model.

A summary of stock option activity was as follows:

	Nine months ended July 31, 2016			
	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
	In thousands		In years	In millions
Outstanding at beginning of period	36,278	$ 26		
Granted	25,424	$ 6		
Exercised	(3,901)	$ 8		
Cancelled Awards	(26,252)	$ 26		
Forfeited and expired	(2,173)	$ 16		
Outstanding at end of period	29,376	$ 12	5.2	$ 66
Vested and expected to vest at end of period	27,680	$ 12	5.1	$ 65
Exercisable at end of period	15,461	$ 11	3.7	$ 58

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value that option holders would have realized had all option holders exercised their options on the last trading day of the third quarter of fiscal 2016. The aggregate intrinsic value is the difference between HP's closing stock price on the last trading day of the third quarter of fiscal 2016 and the exercise price, multiplied by the number of in-the-money options. The total intrinsic value of options exercised for the three and nine months ended July 31, 2016 was $14 million and $21 million, respectively.

At July 31, 2016, there was $22 million of unrecognized pre-tax, stock-based compensation expense related to unvested stock options, which HP expects to recognize over the remaining weighted-average vesting period of 1.9 years.

Note 7: Taxes on Earnings

Tax Matters Agreement and Other Income Tax Matters

In connection with the Separation, HP entered into the TMA with Hewlett Packard Enterprise, effective on November 1, 2015, that governs the rights and obligations of HP and Hewlett Packard Enterprise for certain pre-Separation tax liabilities. The TMA provides that HP and Hewlett Packard Enterprise will share certain pre-Separation income tax liabilities. In certain jurisdictions, HP and Hewlett Packard Enterprise have joint and several liability for past income tax liabilities and accordingly, HP could be legally liable under applicable tax law for such liabilities and required to make additional tax payments.

In addition, if the distribution of Hewlett Packard Enterprise's common shares to the HP stockholders is determined to be taxable, Hewlett Packard Enterprise and HP would share the tax liability equally, unless the taxability of the distribution is the direct result of action taken by either Hewlett Packard Enterprise or HP subsequent to the distribution, in which case the party causing the distribution to be taxable would be responsible for any taxes imposed on the distribution.

Upon completion of the Separation on November 1, 2015, HP recorded income tax indemnification receivables from Hewlett Packard Enterprise for certain income tax liabilities that HP is jointly and severally liable for, but for which it is indemnified by Hewlett Packard Enterprise under the TMA. The actual amount that Hewlett Packard Enterprise may be obligated to pay HP could vary depending upon the outcome of certain unresolved tax matters, which may not be resolved for several years. The net receivable as of July 31, 2016 was $1.1 billion.

Provision for Taxes

HP's effective tax rate for continuing operations was 22.0% and 23.7% for the three months ended July 31, 2016 and 2015, respectively, and 21.7% and 22.2% for the nine months ended July 31, 2016 and 2015, respectively. HP's effective tax rate generally differs from the U.S. federal statutory rate of 35% due to favorable tax rates associated with certain earnings from HP's operations in lower-tax jurisdictions throughout the world. HP has not provided U.S. taxes for all foreign earnings because HP plans to reinvest some of those earnings indefinitely outside the U.S.

In the three and nine months ended July 31, 2016, HP recorded discrete items resulting in net tax expense of $14 million and net tax benefit of $72 million, respectively, for continuing operations. These amounts included a tax benefit of $8 million and $46 million, for the three and nine months ended July 31, 2016, respectively, on restructuring and other charges. The nine months ended July 31, 2016 also included a tax benefit of $41 million arising from the retroactive research and development credit provided by the Consolidated Appropriations Act of 2016 signed into law in December 2015.

In the three and nine months ended July 31, 2015, HP recorded discrete items resulting in net tax expense of $28 million and $12 million, respectively. These amounts included a tax benefit of $1 million and $8 million for the three and nine months ended July 31, 2015, respectively, on restructuring and other charges, and tax expense of $7 million and $36 million for the three and nine months ended July 31, 2015, respectively, related to provision to return adjustments and other tax expense of $22 million and $12 million for the three and nine months ended July 31, 2015, respectively. The nine months ended July 31, 2015 also included a tax benefit of $28 million arising from the retroactive research and development credit provided by the Tax Increase Prevention Act of 2014 signed into law in December 2014.

Uncertain Tax Positions

As of July 31, 2016, the amount of unrecognized tax benefits was $9.6 billion, of which up to $3.4 billion would affect HP's effective tax rate if realized. The amount of unrecognized tax benefits increased by $385 million for the nine months ended July 31, 2016, primarily related to advanced royalty payments, the majority of which are indemnified by Hewlett Packard Enterprise. HP continues to record its tax liabilities related to uncertain tax positions and certain liabilities for which it has joint and several liability with Hewlett Packard Enterprise. During the nine months ended July 31, 2016, as part of the Separation, HP distributed liabilities related solely to uncertain tax positions associated with Hewlett Packard Enterprise aggregating $732 million. HP and Hewlett Packard Enterprise have contractually agreed to share the responsibility of certain tax exposures, and as such have recorded indemnification assets and liabilities pursuant to the TMA. HP recognizes interest income from favorable settlements and interest expense and penalties accrued on unrecognized tax benefits in the provision for taxes in the Consolidated Condensed Statements of Earnings. As of July 31, 2016, HP had accrued $153 million for interest and penalties.

HP engages in continuous discussion and negotiation with taxing authorities regarding tax matters in various jurisdictions. HP does not expect complete resolution of any IRS audit cycle within the next 12 months. However, it is reasonably possible that certain federal, foreign and state tax issues may be concluded in the next 12 months, including issues involving transfer pricing and other matters. Accordingly, HP believes it is reasonably possible that its existing unrecognized tax benefits may be reduced by an amount up to $5 million within the next 12 months.

Deferred Tax Assets and Liabilities

In 2015, the FASB issued Accounting Standards Update ("ASU") 2015-17, "Balance Sheet Classification of Deferred Taxes", which simplifies the presentation of deferred income taxes. This guidance requires that deferred tax liabilities and assets be classified as non-current in a classified statement of financial position. HP early adopted the FASB's new accounting guidance prospectively for the interim period beginning November 1, 2015; thus, the prior reporting period was not retrospectively adjusted.

HP periodically engages in intercompany advanced royalty payment arrangements that may result in advance payments between subsidiaries in different tax jurisdictions. When the local tax treatment of the intercompany licensing arrangements differs from U.S. GAAP treatment, deferred taxes are recognized. During the nine months ended July 31, 2016, HP executed intercompany advanced royalty payment arrangements resulting in advanced payments of $1.1 billion. During fiscal 2015, HP executed an intercompany advanced royalty payment arrangement which resulted in advanced payments of $3.8 billion, with a deferral of intercompany revenues over the term of the arrangements, which is approximately 5 years. There was no recognition of any net U.S. deferred tax assets as a result of this transaction. In these transactions, the payments were received in the U.S.

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Note 7: Taxes on Earnings (Continued)

from a foreign consolidated affiliate, with a deferral of intercompany revenues over the term of the arrangement, which is approximately 5 years. Intercompany royalty revenue is eliminated in consolidation.

Note 8: Balance Sheet Details

Balance sheet details were as follows:

Accounts Receivable

	As of	
	July 31, 2016	October 31, 2015
	In millions	
Accounts receivable	$4,092	$4,905
Allowance for doubtful accounts	(84)	(80)
	$4,008	$4,825

The allowance for doubtful accounts related to accounts receivable and changes were as follows:

	Nine months ended July 31, 2016
	In millions
Balance at beginning of period	$ 80
Provision for doubtful accounts	37
Deductions, net of recoveries	(33)
Balance at end of period	$ 84

HP has third-party arrangements, consisting of revolving short-term financing, which provide liquidity to certain partners in order to facilitate their working capital requirements. These financing arrangements, which in certain circumstances may contain partial recourse, result in a transfer of HP's receivables and risk to the third party. As these transfers qualify as true sales under the applicable accounting guidance, the receivables are derecognized from the Consolidated Condensed Balance Sheets upon transfer, and HP receives a payment for the receivables from the third party within a mutually agreed upon time period. For arrangements involving an element of recourse, the recourse obligation is measured using market data from the similar transactions and reported as a current liability in the Consolidated Condensed Balance Sheets. The recourse obligations as of July 31, 2016 and October 31, 2015 were not material. As of July 31, 2016 and October 31, 2015, HP had $114 million and $93 million, respectively, outstanding from the third parties, which is reported in Accounts receivable in the Consolidated Condensed Balance Sheets. The costs associated with the sales of trade receivables for the three and nine months ended July 31, 2016 and July 31, 2015 were not material.

The following is a summary of the activity under these arrangements:

	Nine months ended July 31, 2016
	In millions

Balance at beginning of period	$ 93
Trade receivables sold	5,896
Cash receipts	(5,873)
Foreign currency and other	(2)
Balance at end of period	$ 114

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Note 8: Balance Sheet Details (Continued)

Inventory

	As of July 31, 2016	October 31, 2015
	In millions	
Finished goods	$2,665	$2,820
Purchased parts and fabricated assemblies	1,296	1,468
	$3,961	$4,288

Other Current Assets

	As of July 31, 2016	October 31, 2015
	In millions	
Value-added taxes receivable	$728	$942
Supplier and other receivables	1,799	1,316
Prepaid and other current assets	1,270	1,193
Deferred tax assets[1]	—	1,047
	$3,797	$4,498

(1) Effective November 1, 2015, HP prospectively adopted ASU 2015-17, "Balance Sheet Classification of Deferred Taxes" and as a result classified all deferred tax assets and liabilities as non-current.

Property, Plant and Equipment

	As of July 31, 2016	October 31, 2015
	In millions	
Land, buildings and leasehold improvements	$2,384	$2,272
Machinery and equipment, including equipment held for lease	3,628	3,459
	6,012	5,731
Accumulated depreciation	(4,405)	(4,239)
	$1,607	$1,492

Other Non-Current Assets

	As of July 31, 2016	October 31, 2015
	In millions	
Tax indemnifications receivable[1]	$1,155	$—
Deferred tax assets[2]	166	216
Other	1,276	1,376
	$2,597	$1,592

(1) In connection with the TMA discussed under Note 7, "Taxes on Earnings".

(2) Effective November 1, 2015, HP prospectively adopted ASU 2015-17, "Balance Sheet Classification of Deferred Taxes" and as a result classified all deferred tax assets and liabilities as non-current.

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Note 8: Balance Sheet Details (Continued)

Other Accrued Liabilities

	As of July 31, 2016	October 31, 2015
	In millions	
Other accrued taxes	$714	$1,007
Warranty	759	871
Sales and marketing programs	2,177	2,181
Other	2,236	2,182
	$5,886	$6,241

Other Non-Current Liabilities

	As of July 31, 2016	October 31, 2015
	In millions	
Pension, post-retirement, and post-employment liabilities	$2,002	$2,203
Deferred tax liability	1,594	1,813
Tax liability	1,050	1,803
Deferred revenue	830	812
Tax indemnifications payable[1]	70	—
Other	730	783
	$6,276	$7,414

[1] In connection with the TMA discussed under Note 7, "Taxes on Earnings".

Note 9: Fair Value

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date.

Fair Value Hierarchy

HP uses valuation techniques that are based upon observable and unobservable inputs. Observable inputs are developed using market data such as publicly available information and reflect the assumptions market participants would use, while unobservable inputs are developed using the best information available about the assumptions market participants would use. Assets and liabilities are classified in the fair value hierarchy based on the lowest level input that is significant to the fair value measurement:

Level 1—Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2—Quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability and market-corroborated inputs.

Level 3—Unobservable inputs for the asset or liability.

The fair value hierarchy gives the highest priority to observable inputs and lowest priority to unobservable inputs.

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HP INC. AND SUBSIDIARIES
Notes to Consolidated Condensed Financial Statements
(Unaudited)
Note 9: Fair Value (Continued)

Assets and Liabilities Measured and Recorded at Fair Value on a Recurring Basis

	As of July 31, 2016 Fair Value Measured Using				As of October 31, 2015 Fair Value Measured Using			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
	In millions							
Assets:								
Cash Equivalents and Investments:								
Time deposits	$—	$1,915	$—	$1,915	$—	$1,111	$—	$1,111
Money market funds	2,527	—	—	2,527	4,303	—	—	4,303
Marketable equity securities	5	4	—	9	6	3	—	9
Foreign bonds	—	47	—	47	—	42	—	42
Other debt securities	—	2	—	2	—	2	—	2
Derivative Instruments:								
Interest rate contracts	—	76	—	76	—	38	—	38
Foreign currency contracts	—	269	1	270	—	213	2	215
Other derivatives	—	5	—	5	—	5	—	5
Total Assets	$2,532	$2,318						