

SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **1994-05-13** | Period of Report: **1994-03-31**  
SEC Accession No. **0000808362-94-000009**

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FILER

**BAKER HUGHES INC**

CIK: **808362** | IRS No.: **760207995** | State of Incorpor.: **DE** | Fiscal Year End: **0930**  
Type: **10-Q** | Act: **34** | File No.: **001-09397** | Film No.: **94528280**  
SIC: **3533** Oil & gas field machinery & equipment

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FORM 10-Q  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
-----

X QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D)  
--- OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended March 31, 1994

OR

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

-----  
Commission file number 1-9397  
-----

BAKER HUGHES INCORPORATED  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction  
of incorporation or organization)  
3900 Essex Lane, Houston, Texas  
(Address of principal executive offices)

76-0207995  
(I.R.S. Employer  
Identification No.)  
77027  
(Zip code)

Registrant's telephone number, including area code: (713) 439-8600  
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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No  
--- ---

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class

Outstanding at April 30, 1994

-----  
Common Stock, \$1.00 par value per share

-----  
140,475,000 shares  
-----

BAKER HUGHES INCORPORATED

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PART I. FINANCIAL INFORMATION  
 BAKER HUGHES INCORPORATED  
 CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS  
 (In thousands, except per share amounts)

	Three Months Ended March 31,		Six Months Ended March 31,	
	1994	1993	1994	1993
REVENUES:	-----		-----	
Sales.....	\$ 453,305	\$ 505,428	\$ 886,787	\$ 999,020
Services and rentals.....	196,711	187,021	387,791	377,502
	-----		-----	
Total revenues.....	650,016	692,449	1,274,578	1,376,522
COSTS AND EXPENSES:	-----		-----	
Cost of sales.....	269,896	300,254	521,827	596,883
Cost of services and rentals...	93,765	96,083	190,645	194,812
Research and engineering.....	23,995	25,794	47,420	52,201
Marketing and field service....	147,613	154,211	295,057	308,577
General and administrative.....	51,605	50,448	104,920	101,629
Amortization of goodwill and other intangibles.....	7,504	9,159	15,465	18,505
Unusual charges.....		24,500		42,000
	-----		-----	
Total costs and expenses...	594,378	660,449	1,175,334	1,314,607
	-----		-----	
Operating income.....	55,638	32,000	99,244	61,915
Interest expense.....	16,588	18,798	31,779	36,460
Interest income.....	(1,102)	(1,862)	(1,788)	(3,573)
	-----		-----	
Income before income taxes.....	40,152	15,064	69,253	29,028
Income taxes.....	16,864	12,265	29,086	22,019
	-----		-----	
Income before cumulative effect of accounting changes.....	23,288	2,799	40,167	7,009
			-----	
Cumulative effect of accounting changes:				
Income taxes.....			25,455	
Postretirement benefits other than pensions (net of \$37.5				

million income tax benefit)...				(69,620)
Accounting changes - net...				(44,165)
Net income (loss).....	\$ 23,288	\$ 2,799	\$ (3,998)	\$ 7,009
Per share of Common Stock:	=====	=====	=====	=====
Income before cumulative effect of accounting changes.....	\$ .14	\$ .00	\$ .24	\$ .01
Cumulative effect of accounting changes.....			(.32)	
Net income (loss).....	\$ .14	\$ .00	\$ (.08)	\$ .01
Cash dividends per share of common stock.....	\$ .115	\$ .115	\$ .23	\$ .23

See accompanying notes to consolidated condensed financial statements.

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BAKER HUGHES INCORPORATED  
CONSOLIDATED CONDENSED STATEMENTS OF FINANCIAL POSITION  
(In thousands)

ASSETS

	March 31, 1994	September 30, 1993
	-----	-----
CURRENT ASSETS:		
Cash and cash equivalents.....	\$ 13,515	\$ 6,992
Receivables - net.....	564,329	619,953
Inventories:		
Finished goods.....	505,217	467,806
Work in process.....	55,694	68,408
Raw materials.....	89,116	102,926
Total inventories.....	650,027	639,140
Net assets of business held for sale.....	111,070	126,430
Deferred income taxes.....	55,500	2,990
Other current assets.....	31,028	21,301
Total current assets.....	1,425,469	1,416,806
PROPERTY - NET.....	590,395	661,463
OTHER ASSETS:		

Property held for disposal.....	79,841	72,717
Investments.....	100,285	98,864
Notes receivable.....	21,528	25,486
Other assets.....	59,225	53,934
Excess costs arising from acquisitions - net....	808,324	814,070
	-----	-----
Total other assets.....	1,069,203	1,065,071
	-----	-----
Total.....	\$ 3,085,067	\$ 3,143,340
	=====	=====

See accompanying notes to consolidated condensed financial statements.

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BAKER HUGHES INCORPORATED  
CONSOLIDATED CONDENSED STATEMENTS OF FINANCIAL POSITION  
(In thousands)

LIABILITIES AND STOCKHOLDERS' EQUITY

	March 31, 1994	September 30, 1993
	-----	-----
CURRENT LIABILITIES:		
Accounts payable.....	\$ 200,791	\$ 249,781
Short-term borrowings and current portion of long-term debt.....	6,699	8,448
Accrued employee compensation and benefits.....	110,011	95,303
Taxes other than income.....	18,938	22,552
Accrued insurance.....	22,449	20,554
Accrued interest.....	16,320	11,529
Income taxes.....	16,757	15,322
Other accrued liabilities.....	68,659	72,348
	-----	-----
Total current liabilities.....	460,624	495,837
	-----	-----
LONG-TERM DEBT.....	855,951	935,846
	-----	-----
DEFERRED INCOME TAXES.....	51,446	78,306
	-----	-----

POSTRETIREMENT BENEFITS OTHER THAN PENSIONS.....	99,832	
	-----	
OTHER LONG-TERM LIABILITIES.....	22,295	22,703
	-----	-----
STOCKHOLDERS' EQUITY:		
Preferred stock.....	4,000	4,000
Common stock.....	140,443	140,437
Capital in excess of par value.....	1,466,501	1,444,549
Retained earnings.....	116,977	159,277
Cumulative foreign currency translation adjustment.....	(133,002)	(137,615)
	-----	-----
Total stockholders' equity.....	1,594,919	1,610,648
	-----	-----
Total.....	\$ 3,085,067	\$ 3,143,340
	=====	=====

See accompanying notes to consolidated condensed financial statements.

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BAKER HUGHES INCORPORATED  
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS  
(In thousands)

	Six Months Ended March 31,	
	1994	1993
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss).....	\$ (3,998)	\$ 7,009
Adjustments to reconcile net income (loss) to net cash flows from operating activities:		
Depreciation and amortization of:		
Property.....	65,387	68,754
Other assets and debt discount.....	23,513	21,909
Gain on disposal of assets.....	(5,014)	(6,443)
Gain on disposition of EM&C.....	(8,550)	
Foreign currency translation loss - net.....	9	11
Cumulative effect of accounting changes.....	44,165	
Changes in assets and liabilities:		
Change in receivables.....	17,712	(46,140)
Change in inventories.....	(58,736)	(16,685)
Change in accounts payable.....	(23,310)	(5,918)

Changes in other assets and liabilities.....	(13,367)	3,167
	-----	-----
Net cash flows from operating activities.....	37,811	25,664
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
Property additions.....	(56,613)	(58,929)
Proceeds from disposal of assets.....	16,132	19,916
Proceeds from disposition of EM&C.....	128,389	
	-----	-----
Net cash flows from investing activities.....	87,908	(39,013)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net borrowings (payments) from commercial paper and revolving credit facilities.....	(81,540)	79,019
Redemption of debentures.....		(21,361)
Proceeds from exercise of stock options and stock purchase grants.....	62	1,904
Dividends.....	(38,302)	(37,900)
	-----	-----
Net cash flows from financing activities.....	(119,780)	21,662
	-----	-----
Effect of exchange rate changes on cash.....	584	(3,698)
	-----	-----
Increase in cash and cash equivalents.....	6,523	4,615
Cash and cash equivalents, beginning of period.....	6,992	6,692
	-----	-----
Cash and cash equivalents, end of period.....	\$ 13,515	\$ 11,307
	=====	=====
Income taxes paid.....	\$ 23,020	\$ 19,188
Interest paid.....	\$ 24,402	\$ 30,317

See accompanying notes to consolidated condensed financial statements.

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BAKER HUGHES INCORPORATED

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

Note 1. General

In the opinion of the Company, the unaudited consolidated condensed financial statements include all adjustments consisting of normal recurring accruals necessary for a fair presentation of the Company's consolidated financial position as of March 31, 1994 and 1993 and its consolidated results of operations and cash flows for each of the three and six month periods ended March 31, 1994 and 1993. Although the Company believes that the disclosures in these financial statements are adequate to make the information presented not misleading, certain information and footnote disclosures normally included in annual financial statements prepared in accordance with generally accepted



accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (See the Company's Annual Report on Form 10-K for the year ended September 30, 1993 for the most recent annual financial statements prepared in accordance with generally accepted accounting principles). Certain balances on the Consolidated Statement of Financial Position at September 30, 1993 have been reclassified to conform to the March 31, 1994 presentation. The results of operations for the three and six months ended March 31, 1994 are not necessarily indicative of the results to be expected for the full year.

#### Note 2. Income(Loss) Per Common Share

Net income (loss) per common share is based on the weighted average number of shares outstanding during the respective periods (three months ended March 31, 1994 and 1993, 140,443,000 and 138,794,000, respectively; six months ended March 31, 1994 and 1993, 140,442,000, and 138,722,000, respectively) and excludes the negligible dilutive effect of shares issuable in connection with employee stock plans. Net income (loss) per common share has been adjusted for dividends on preferred stock of \$3.0 million and \$6.0 million for the three months and six months ended March 31, 1994 and 1993, respectively.

#### Note 3. Income Taxes

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes," effective October 1, 1993. Previously, the Company used SFAS No. 96, "Accounting for Income Taxes". The cumulative effect of adopting SFAS No. 109 on the Company's consolidated financial statements was a credit to income of \$25.5 million (\$.18 per share).

Deferred income taxes reflect the net tax effects of (a) temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes, and (b) operating loss and tax credit carryforwards. The tax effects of the Company's temporary differences and carryforwards at October 1, 1993 are as follows (in thousands):

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### BAKER HUGHES INCORPORATED

#### NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS CONTINUED

##### Deferred tax liabilities:

Property	\$ 65,750
Investments	35,600
Excess costs arising from acquisitions	43,800
Undistributed earnings of foreign subsidiaries	23,000

Other	16,600
	-----
Total	\$ 184,750
	=====
Deferred tax assets:	
Receivables	\$ 5,700
Inventory	48,900
Postretirement benefits other than pensions	37,500
Other liabilities	25,600
Operating loss carryforwards	51,350
Tax credit carryforwards	59,600
Other	12,150
	-----
	240,800
Valuation allowance	(33,966)
	-----
Total	\$ 206,834
	=====

A valuation allowance is recorded when it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of the deferred tax assets depends on the ability to generate sufficient taxable income of the appropriate character in the future. The valuation allowance relates to the realization of operating loss carryforwards in certain non-U.S. jurisdictions and foreign tax credit carryforwards in the U.S.

As a result of applying SFAS No. 109, previously unrecorded deferred tax assets related to net deductible temporary differences, tax credit carryforwards and operating loss carryforwards were recognized at October 1, 1993 as part of the cumulative effect of adopting the statement. Under prior accounting, a part of these benefits would have been recognized as a reduction of income tax expense in the period utilized. This is evident in the effective tax rate, adjusted for the unusual charges, for the three months and six months ended March 31, 1993 of 31.0%. Accordingly, the adoption of SFAS No. 109 at the beginning of 1994 had the effect of increasing the effective tax rate for the three months and six months ended March 31, 1994 to 42.0%.

The provision for income tax expense for the three months ended March 31, 1994 was \$16.9 million, of which \$2.8 million and \$14.1 million is current and deferred expense, respectively. The provision for income tax expense for the six months ended March 31, 1994 was \$29.1 million, of which \$10.1 million and \$19.0 million is current and deferred expense, respectively.

In conjunction with the adoption of SFAS No. 109, a benefit of \$21.9 million was allocated to capital in excess of par value in the first quarter of 1994, which reflects the cumulative tax effect of stock options exercised by employees of the Company for which the Company has taken tax deductions in its federal tax return.

Provision has been made for U.S. and additional foreign taxes for the anticipated repatriation of certain earnings of foreign subsidiaries of the Company. The Company considers the undistributed earnings of its foreign subsidiaries above the amount already provided to be permanently reinvested. These additional foreign earnings could become subject to additional tax if remitted as a dividend, lent by the foreign subsidiary to the Company or if the Company should sell its stock in the subsidiary. The additional amount of taxes payable are not practicable to estimate but the Company believes they would not be material due to offsetting foreign tax credits generated by the repatriation of such earnings.

#### Note 4. Postretirement Benefits Other than Pensions

The Company adopted SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other than Pensions" effective October 1, 1993. The statement requires that the estimated cost of postretirement benefits other than pensions be accrued over the period earned rather than expensed as incurred.

The cumulative effect of adopting SFAS No. 106 on the immediate recognition basis, as of October 1, 1993, was a charge to income of \$69.6 million (\$.50 per share), net of an income tax benefit of \$37.5 million.

The Company provides postretirement health care and life insurance benefits for substantially all U.S. employees. In fiscal 1993 and 1992, the Company recognized \$9.5 million and \$8.4 million, respectively, as expense for postretirement health care and life insurance benefits. Expense to be recognized in fiscal 1994 under SFAS No. 106 is expected to be approximately \$8.8 million. The Company's postretirement plans are not funded. The status of the plan is as follows:

Accumulated postretirement benefit obligation ("APBO") at October 1, 1993 (in thousands):

Retirees	\$ 73,300
Fully eligible active plan participants	10,300
Other active plan participants	23,500
	-----
APBO	\$ 107,100
	=====

BAKER HUGHES INCORPORATED

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS CONTINUED

Net periodic postretirement benefit cost for 1994 (in thousands):

	Three Months Ended March 31, 1994	Six Months Ended March 31, 1994
	-----	-----
Service cost of benefits earned during the quarter	\$ 325	\$ 650
Interest cost on APBO	1,875	3,750
	-----	-----
Net postretirement benefit cost	\$ 2,200	\$ 4,400
	=====	=====

The assumed health care cost trend rate used in measuring the APBO as of October 1, 1993 was 12.2% for 1994 declining gradually each successive year until it reaches 5% in 2002, after which it remains constant. A 1% increase in the trend rate for health care costs would have increased the APBO by approximately 8% and the aggregate of the service and interest cost components of the net periodic postretirement benefit cost by approximately 9%. The assumed discount rate used in determining the APBO was 7%.

Note 5. Dispositions

In March 1994, the Company announced its intent to dispose of the EnviroTech Pumpsystems ("EPS") group of companies. EPS provides a variety of specialized pumps to the mineral, mining, chemical, petro-chemical and municipal markets. The decision to divest EPS is part of a continuing review of the Company's core product and service competencies. Accordingly, the net assets of the EPS operations have been classified as a current asset at March 31, 1994, anticipating that the disposition will occur within twelve months. EPS provided revenues and profits of \$213.0 million and \$15.0 million, respectively, in the fiscal year 1993. The proceeds from any disposition would be redeployed in a manner that will prevent dilution to future earnings. Such action could include reduction of debt by repurchase or repayment.

In July 1993, the Company announced that the EnviroTech Measurements & Controls ("EM&C") group of companies would no longer be considered part of its core business. In March 1994, the Company completed the sale of EM&C. The sale provided \$128.4 million in cash and resulted in a pre-tax gain of \$8.6 million. The sale excluded the computer peripherals business in Europe operated under the name of Tracor Europa.

Note 6. Unusual Charge

During the first quarter of 1993, the Company recognized an unusual charge of \$17.5 million in connection with reaching an agreement with representatives

of the class plaintiffs for the settlement of a class action civil antitrust lawsuit concerning the marketing of tricone rock bits. A cash payment was made in April 1993 of \$17.5 million. See Note 7.

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BAKER HUGHES INCORPORATED

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS CONTINUED

During the second quarter of fiscal 1993, the Company, along with Dresser Industries and Parker & Parsley Petroleum Development Incorporated, entered into a Memorandum of Understanding covering the settlement of all outstanding litigation among the parties. In recognition of settlement, the Company recorded an unusual charge of \$24.5 million. A cash payment was made for the Company's portion in May 1993 of \$57.5 million. See Note 7.

Note 7. Litigation

PARKER & PARSLEY

On September 8, 1992, Parker & Parsley Petroleum Development Incorporated ("PDP") filed a lawsuit alleging intentional product delivery or service variances on a number of well stimulation projects in West Texas for PDP and certain related parties in the 238th Judicial District Court in Midland, Texas seeking in excess of \$120.0 million in actual and punitive damages. This case was similar to a case in federal court which had previously been vacated by the U.S. Fifth Circuit Court of Appeals. In connection with the initial public offering by BJ Services Company ("BJ"), the Company agreed to indemnify BJ for damages and costs of litigation arising out of said allegations or similar claims from any other customers prior to the date of the initial public offering.

On May 26, 1993, the Company and Dresser Industries ("DI") made a cash payment, shared equally, of \$115.0 million to PDP to settle all outstanding claims among the parties in this litigation. The Company previously established a reserve for this litigation and also had access to additional third party funds from contractual arrangements. Since the Company was unable to reach timely agreement with its insurance carriers, the Company recorded a charge to earnings of \$24.5 million in the quarter ended March 31, 1993. In April 1994 a settlement was reached with the insurance carriers. A recovery of approximately \$20 million, net of expenses, is expected to be received in May 1994. This gain will be recorded in the quarter ending June 30, 1994.

In this regard, Ms. E. M. Filter, a director of the Company and an executive officer of Xerox Corporation, had disclosed that two subsidiaries of Talegen Holdings, Inc., a wholly owned subsidiary of Xerox Financial Services, Inc., had been sued by the Company in connection with the litigation. On June 17, 1991, the Company filed a Complaint against its insurers, including

the two subsidiaries of Talegen Holdings, Inc., styled Baker Hughes Incorporated, et. al. v. Underwriters of Lloyds et. al. in the 333rd Judicial District Court in Harris County, Texas. At the time of the settlement with PDP, Ms. Filter advised the Company that a conflict of interest existed in this matter and requested exclusion from any further discussions regarding insurance coverage in connection with the PDP litigation.

GLYN SNELL

On February 15, 1991, Glyn Snell, et. al. filed a class action suit on behalf of royalty interest owners in 238th Judicial District Court in Midland

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#### BAKER HUGHES INCORPORATED

#### NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS CONTINUED

County, Texas, implicating DI, BJ, the Company and affiliates in damages to the same wells included in the PDP litigation. On September 30, 1993, the Company and DI agreed to make a cash payment, shared equally, of \$15.0 million to the class pursuant to a Settlement Agreement. An Order Preliminarily Approving The Settlement, Directing Notice To The Class and Setting a Hearing on Proposed Settlement on April 18, 1994 (now postponed to June 30, 1994) was entered by the Court on October 1, 1993. The Company has adequate reserves recorded at March 31, 1994 with respect to this matter.

#### MISSION RESOURCES

On June 30, 1992, the Company was notified of a suit against BJ and certain individual defendants filed by Mission Resources, Inc. - II ("Mission") in the Superior Court for the State of California for the County of Kern, alleging fraudulent misrepresentation, negligent misrepresentation, fraud, breach of contract and violations of RICO in connection with product delivery or service variances on approximately 53 well stimulation projects performed by BJ-Hughes, in Kern County in late 1983 and early 1984. Although the suit does not name the Company as a defendant, the allegations may fall within the Company's agreement, in connection with the initial public offering by BJ, to indemnify it for damages, if any, and costs of litigation arising out of any such claims. BJ has removed the case to the United States District Court for the Eastern District of California, Fresno Division. On January 27, 1994, Mission amended its complaint to include an allegation of negligence. The suit seeks general damages in the amount of at least \$15.0 million and treble damages in the amount of at least \$45.0 million. This case is in its early stages with no discovery on the merits having occurred.

#### DEPARTMENT OF JUSTICE INVESTIGATION

On January 2, 1991, the Company and Hughes Christensen Company received a United States federal grand jury subpoena requesting documents relating to the

marketing of tricone rock bits. Six other tricone rock bit manufacturers received similar subpoenas with respect to the same investigation being conducted by the Department of Justice.

On July 13, 1992, pursuant to an agreement with the Justice Department, HCC pleaded guilty to a one count criminal information alleging that it had conspired to fix the price of tricone rock bits for a period of nine weeks in 1989 in violation of Section 1 of the Sherman Act. A fine of \$1.0 million was imposed by the Court upon acceptance of the plea.

As a consequence of the Justice Department investigation, the Company and three other major producers of tricone rock bits were sued civilly by several litigants, including Red Eagle Resources Corporation Inc., alleging unspecified damages and claiming to represent a class of purchasers of such rock bits who had been damaged as a consequence of a conspiracy in violation of Section 1 of the Sherman Act. The civil suits have been consolidated in a single action in the Southern District of Texas, Houston Division. On September 8, 1992, the trial court entered an order provisionally certifying the case as a class action on behalf of all purchasers of insert and milled tooth tricone rock bits

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BAKER HUGHES INCORPORATED

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS CONTINUED

for domestic use from September 1986 to January 1992. On January 27, 1993, the Company reached an agreement with the representatives of the class plaintiffs to settle this suit for \$17.5 million. On April 26, 1993, the settlement was approved by the Court and a judgement dismissing claims against the Company on behalf of the class was entered. A charge to earnings of \$17.5 million was recorded in the first quarter of 1993. On September 17, 1993, the Court notified the class that an Additional Settlement Agreement had been entered into on behalf of the class with two other defendants. Because the prior settlement with the Company contained a most favored nations clause requiring a refund to the Company if a later settlement with any other defendants is more favorable, the Company received a refund of \$2.1 million in the first quarter of 1994. One antitrust action by a customer who opted out of the class settlement remains pending. This customer's claim represented four percent of the original class.

TRW INC.

On May 30, 1989, TRW Inc. ("TRW") filed suit against the Company, Bird Machine Company, Inc. (a wholly owned subsidiary of the Company) ("BMC"), and Bird Incorporated (the previous parent of BMC), in the U.S. District Court for the Southern District of Texas, Houston Division, alleging breach of express warranty, fraud, and breach of a duty of good faith and fair dealing, in connection with the sale of certain disc and decanter machines sold to TRW by BMC prior to the acquisition of BMC by the Company in 1989. On April 29, 1992, the jury found that TRW had suffered damages. The District Court, on July 30, 1992, entered a final judgment in the amount of \$7.7 million together

with prejudgment and post-judgment interest. The United States Court of Appeals for the Fifth Circuit affirmed the District Court's decision, and denied the Company's appeal to rehear portions of the case in December 1993. In January 1994, the Company paid \$10.4 million to TRW in satisfaction of the judgment.

#### Note 8. Debt

In March 1994, the Company entered into an interest rate swap that will begin in October 1994 and mature in January 2000. Under the terms of the swap, the Company will receive a fixed rate of interest and pay a floating rate of interest on a notional amount of \$93.0 million.

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

#### BUSINESS ENVIRONMENT

Oilfield Operations companies manufacture, sell and provide services used in the drilling, completion and maintenance of oil and gas wells. The business environment of the Company is significantly affected by worldwide expenditures of the petroleum industry. Important factors establishing the levels of these expenditures include world economic conditions, crude oil and natural gas supply and demand balances, the legislative environment in the United States and other major countries, and developments in the Middle East and other major petroleum producing regions.

#### ACTIVITY INDICATORS

Crude oil and natural gas prices are a major determinant of exploration and development expenditures. (The amounts in the table below are quarter averages for the period.)

Three Months Ended		Six Months Ended	
March 31,		March 31,	
1994	1993	1994	1993

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WTI (\$/Bbl)	14.79	19.89	15.56	20.20
U.S. Spot Natural Gas (\$/mcf)	2.19	1.89	2.11	2.02

Oil prices weakened in the second quarter and first six months of 1994 falling \$5.10/Bbl or 25.6% and \$4.64/Bbl or 23.0%, respectively, compared to the same periods a year ago. The Company expects prices to be flat, ranging between \$15 and \$20/Bbl for the next several years. U.S. natural gas prices strengthened in 1994, increasing 15.9% for the quarter and 4.5% for the six months. Prices are expected to increase modestly over the next year. The Company believes that higher natural gas prices and a tightening market should stimulate exploration and development drilling directed towards natural gas.

A more direct indicator of expenditures and drilling activity is the Baker Hughes rotary rig count. Workover activity, as measured by the U.S. workover rig count, is also an indicator of expenditure activity. (The amounts in the table below are quarter averages for the period.)

	Three Months Ended		Six Months Ended	
	March 31,		March 31,	
	1994	1993	1994	1993
-----				
North American	1,052	914	1,072	959
Non-North American	749	764	764	789
	-----	-----	-----	-----
Total Rig Count	1,801	1,678	1,836	1,748
	=====	=====	=====	=====
U.S. Workover Rig Count	1,309	1,340	1,419	1,407
	=====	=====	=====	=====

Total drilling activity was 7.3% higher in the second quarter of 1994 and 5.0% higher in the first six months of 1994 when compared to the same periods in 1993. Activity increases in North America were offset by activity decreases in the non-North American markets.

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## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION

### AND RESULTS OF OPERATIONS CONTINUED

#### North American Activity

The North American rig count was up 15.1% for the quarter and 11.8% for the six months. Activity increases in the Gulf of Mexico drove an increase in the average offshore rig count from 68 to 97 rigs -- up 42.6% from the second quarter of 1993 and from 63 to 98 rigs -- up 55.6% from the first six months of 1993. The Company benefits from offshore drilling, more so than land drilling, as this type of activity requires the premium products and services offered by the Company. The Canadian operations were also favorably impacted by the increase in gas drilling as Canadian rig activity was up 37.8% and 51.1% for the quarter and six months year over year. U.S. workover activity was down 2.3% for the quarter and up .9% for the six months from 1993 levels.

The outlook for North American activity continues to be positive as the Company expects gas-directed drilling to increase over the next year. In Canada, the increase in gas-directed drilling should continue. The average U.S. workover rig count is expected to increase slightly in 1994.

#### Non-North American Activity

Outside North America, activity continued to fall. The average rig count was down 2.0% for the quarter and 3.2% for the six months. The fall was widespread as most regions showed a decrease in activity. Two areas of particular importance to the Company that were down significantly were Italy and Nigeria. The Company expects little change in international activity over the near term. Political issues and softness in crude oil prices will continue to create uncertainty in key international markets.

#### DISPOSITIONS

In March 1994, the Company announced its intent to dispose of the EnviroTech Pumpsystems ("EPS") group of companies. EPS provides a variety of specialized pumps to the mineral, mining, chemical, petro-chemical and municipal markets. The decision to divest EPS is part of a continuing review of the Company's core product and service competencies. Accordingly, the net assets of the EPS operations have been classified as a current asset at March 31, 1994, anticipating that the disposition will occur within twelve months. EPS provided revenues and profits of \$210.0 million and \$15.0 million, respectively, in the fiscal year 1993. The proceeds from any disposition would be redeployed in a manner that will prevent dilution to future earnings. Such action could include reduction of debt by repurchase or repayment.

In July, 1993, the Company announced that the EnviroTech Measurements & Controls ("EM&C") group of companies would no longer be considered part of its core business. In March 1994, the Company completed the sale of EM&C. The sale provided \$128.4 million in cash and resulted in a pre-tax gain of \$8.6 million. The sale excluded the computer peripherals business in Europe operated under the name of Tracor Europa.

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

#### RESULTS OF OPERATIONS

Selected Consolidated Results (In millions)	Three Months Ending		Six Months Ending	
	March 31,		March 31,	
	1994	1993	1994	1993
Revenues	\$ 650.0	\$ 692.4	\$1,274.6	\$1,376.5
	=====	=====	=====	=====

Operating Income Before Unusual				
Charges	55.6	56.5	99.2	103.9
Unusual Charge		24.5		42.0
	-----	-----	-----	-----
Operating Income	\$ 55.6	\$ 32.0	\$ 99.2	\$ 61.9
	=====	=====	=====	=====

## Revenues

Consolidated revenues for the three months and six months ended March 31, 1994 decreased 6.1% and 7.4%, respectively, compared to the same periods last year. The quarter and six months ended March 31, 1993 include the results of EM&C revenues of \$48.9 million and \$92.1 million, respectively. Excluding EM&C, revenues were up 1.0% for the quarter with virtually no change for the six months. Sales revenues were down in the 1994 periods because of the sale of EM&C and decreases in EnviroTech Process Equipment and EPS. Process Equipment and EPS operations consist primarily of sales revenue. The services and rentals revenue increases result from the Oilfield Operations.

Oilfield Operations reported revenues of \$531.8 million for the quarter, compared to \$513.2 million for the 1993 quarter, an increase of \$18.6 million. Revenues for the six months increased \$19.6 million to \$1.05 billion compared to 1993. Much of the improvement in both sales and service and rental revenues is attributable to increased drilling activity in the Western Hemisphere fueled by higher natural gas prices, specifically U.S. offshore and Canada. Latin America's improved business and economic climate coupled with the development of several large projects, has resulted in higher sales and service and rental revenues in this region as well. However, much of the improvement in the Western Hemisphere markets was offset by declines in the European and West Africa Markets, most notably in geographic areas where Oilfield Operations enjoys significant revenue on a per rig basis.

The operations of the EnviroTech group which currently consist of the EnviroTech Process Equipment group of companies had revenues of \$59.5 million for the second quarter of 1994, down \$13.4 million from 1993, and \$118.3 million for the first six months of 1994, down \$18.6 million from 1993. These results exclude EM&C, which was sold during the quarter, as well as EPS due to the planned sale of this business. Political uncertainty in the countries of the former Soviet Union and several large project deferrals due to financing delays are the major factors in the sales and services and rentals decline.

Revenues from businesses held for sale, which consist primarily of the EPS group of companies, were \$61.3 million for the quarter, down 8.4%, and \$111.6 million for the six months, down 8.8%. The decrease is due primarily to the general weakness in the worldwide economy and several large orders in the prior year.

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

## Operating Income

Operating income increased 73.8% in the second quarter of 1994 compared to 1993. Results for 1993 include the impact of an unusual charge, discussed below, of \$24.5 million. Excluding the unusual charge, operating income decreased 1.6%. Operating income increased 60.3% in the first six months of 1994 compared to 1993. Results for 1993 include the impact of unusual charges, discussed below, of \$42.0 million. Excluding the unusual charges, operating income decreased 4.5%.

Cost of sales, cost of services and rentals, research and engineering expenses and marketing and field service expenses decreased in the 1994 periods in line with the revenue decreases. General and administrative expenses, which are less sensitive to changes in revenue, increased in 1994. The increase is due primarily to a net gain of \$2.0 million recorded in the second quarter of 1993 in connection with the termination of a defined benefit pension plan. Amortization of goodwill and other intangibles has decreased because of the sale of EM&C.

Operating income for Oilfield Operations was \$52.8 million for the quarter, compared to \$51.7 million in 1993, a 2.1% increase. Operating income for the six months was \$100.6 million, compared to \$84.3 million in 1993, a 19.3% increase. Results for the first six months of 1993 include the impact of a \$17.5 million unusual charge. Excluding the impact of the unusual charge, Oilfield Operations' operating income for the six months decreased 1.2%. The EnviroTech group contributed operating income of \$3.1 million in the second quarter of 1994, compared to \$4.8 million in the second quarter of 1993. Operating income for the six months was \$5.1 million, compared to \$7.3 million in 1993.

Operating income for businesses held for sale was \$4.9 million for the quarter, down \$1.8 million, and \$8.4 million for the six months, down \$3.6 million.

Offsetting the \$8.6 million gain recorded on the sale of EM&C, the Company provided a reserve of \$4.4 million to discontinue certain Oilfield Operations in Mexico, recorded a \$2.1 million provision to writedown certain excess facilities to their net realizable value and accrued \$2.0 million for certain litigation.

## Unusual Charge

1993: During the first quarter of 1993, the Company recognized a charge of \$17.5 million relating to an agreement for the settlement of the civil antitrust litigation involving the marketing of tricore rockbits. During the second quarter of fiscal 1993, the Company, along with Dresser Industries and Parker & Parsley Petroleum Development Incorporated, entered into a Memorandum of Understanding covering the settlement of all outstanding litigation among the parties. In recognition of settlement, the Company recorded an unusual charge of \$24.5 million.

## AND RESULTS OF OPERATIONS CONTINUED

## Interest Expense

Interest expense in the second quarter of 1994 decreased \$2.2 million from the same quarter a year ago. Interest expense for the first six months of 1994 decreased \$4.7 million compared to 1993. The decreases are attributable to lower effective interest rates coupled with a decrease in total debt outstanding.

## Income Taxes

The effective income tax rate for the second quarter and first six months of 1994 was 42.0% as compared to 81.4% and 75.9%, respectively, in 1993. The effective rate in 1993 differs from the federal statutory rate due primarily to nondeductible goodwill amortization, unusual charges for which a benefit is not currently recognizable and foreign earnings taxed at higher effective tax rates. The Company determined its tax provision in 1993 under SFAS No. 96. The effective rate for 1994 differs from the federal statutory rate due primarily to nondeductible goodwill amortization, disallowance of certain expenses and foreign earnings taxed at higher effective tax rates. The Company determined its tax provision for 1994 under SFAS No. 109.

## CAPITAL RESOURCES AND LIQUIDITY

## Financing Activities

Net cash outflows from financing activities were \$119.8 million in the first six months of 1994 compared to cash inflows of \$21.7 million in the first six months of 1993. The Company used the proceeds from the sale of EM&C to reduce debt levels. Borrowings were used in 1993 to fund operating needs. In December 1992, the Company used cash to redeem in full its 9% debentures for \$18.2 million.

Total debt outstanding at March 31, 1994 was \$862.7 million, compared to \$944.3 million at September 30, 1993. The debt to equity ratio was .541 at March 31, 1994, compared to .586 at September 30, 1993.

At March 31, 1994, the Company had \$514.2 million of credit facilities with commercial banks, of which \$346.9 million is committed. These facilities are subject to normal banking terms and conditions and do not materially restrict the Company's activities.

## Investing Activities

Net cash inflows from investing activities were \$87.9 million in the first six months of 1994 compared to cash outflows of \$39.0 million in the first six months of 1993. The sale of EM&C in March 1994 provided \$128.4 million in cash. Property additions have decreased from \$58.9 million in 1993 to \$56.6 million in 1994. The ratio of capital expenditures to depreciation has

increased slightly over the same period from 85.7% to 86.6%. The Company targets a capital expenditure to depreciation ratio of approximately 80% which

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

it believes is adequate to support current levels of operations. The majority of the capital expenditures have been in the Oilfield segment where the largest single item is the expenditure for rental tools and equipment to supplement the rental fleet. Funds provided from operations and outstanding lines of credit are expected to be more than adequate to meet future capital expenditure requirements.

#### Operating Activities

Net cash inflows from operating activities were \$37.8 million in the first six months of 1994 compared to \$25.7 million in the first six months of 1993. The increase of \$12.1 million in 1994 was due primarily to the collection of receivables and an increase in income before cumulative effect of accounting changes. These sources of cash were offset to some degree by the build up of inventories in Oilfield Operations due to increased activity in the U.S. and Latin America compared to 1993.

#### ACCOUNTING STANDARDS

##### Postretirement Benefits Other Than Pensions

In December 1990, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard ("SFAS") No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions". The statement requires accrual basis accounting for future postretirement benefits rather than cash basis accounting. The Company adopted this statement effective October 1, 1993.

The Company elected to immediately recognize the cumulative effect of the change in accounting and recorded a charge of \$107.1 million (\$69.6 million net of income tax benefit) in the first quarter of 1994.

##### Accounting for Income Taxes

In February 1992, the FASB issued SFAS No. 109, "Accounting for Income Taxes". The statement requires an asset and liability approach for financial accounting and reporting of income taxes. The Company adopted SFAS No. 109 effective October 1, 1993, without restatement of prior years and recorded a credit to income of \$25.5 million in the first quarter of 1994.

The Company established valuation reserves for certain of its deferred tax assets which management deemed the realization was not likely to occur. In the

U.S. jurisdiction, the Company has fully reserved the credit portion of all its foreign tax credit carryforwards based on a recent historical pattern of expiring foreign tax credits and the lack of foreign sourced taxable income in amounts sufficient to utilize the foreign tax credit carryforwards. The Company has also reserved the operating loss carryforwards in certain non-U.S. jurisdictions where its operations have decreased, currently ceased or the Company has withdrawn entirely.

The Company has not established valuation reserves on its remaining

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## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION

### AND RESULTS OF OPERATIONS CONTINUED

deferred tax assets. Management believes that sufficient sources of taxable income will occur in the applicable future periods so that these tax assets will be utilized. This judgement is based on recent profitable operations, before unusual charges, in the appropriate jurisdictions.

The adoption of SFAS No. 109 has the practical effect of allowing the Company to report its tax assets, net of valuation reserves, on the Consolidated Statement of Financial Position. Additionally, the statement allows the netting of the noncurrent deferred tax assets and liabilities within the same taxing jurisdiction. The Company has used this approach in reporting its tax accounts in the Consolidated Statement of Financial Position at March 31, 1994.

#### Postemployment Benefits

In November 1992, the FASB issued SFAS No. 112, "Employers' Accounting for Postemployment Benefits". The statement, like SFAS 106, requires accrual basis accounting for such benefits as opposed to cash basis accounting. The Company plans to adopt SFAS No. 112 in fiscal 1995 and immediately recognize the cumulative effect of the change in accounting. The Company currently estimates an accumulated postponement benefit obligation at October 1, 1994 of approximately \$23.0 million. The reduction in the Company's estimate from the first quarter of 1994 of \$35.0 million is the result of recent legislation stating that Medicare benefits would be the primary coverage for certain disabled employees covered by the Company's long-term disability plan.

#### Investments in Debt and Equity Securities

In May 1993, the FASB issued SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities", that will supersede SFAS No. 12 that required marketable equity securities be carried at lower of aggregate cost or market. As it relates to the Company, SFAS No. 115 requires that investments in debt and equity securities should be reported at fair value with changes in the fair value recorded in a separate component of stockholders' equity. The Company plans to adopt SFAS No. 115 in fiscal 1995 and currently estimates it will not have a material impact on the consolidated financial

statements.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

See Note 7 of Notes to Consolidated Condensed Financial Statements.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

None.

(b) Reports on Form 8-K:

None.



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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

BAKER HUGHES INCORPORATED  
(Registrant)

Date: May 13, 1994

By /s/FRANKLIN MYERS

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Vice President and General Counsel

Date: May 13, 1994

By /s/JAMES E. BRAUN

-----  
Controller

