HALLIBURTON CO
Form 10-Q/A
April 04, 2003

FORM 10-Q/A

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 June 30, 2002

OR

[ ] Transition Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934
For the transition period from _____ to _____

Commission File Number 1-3492

HALLIBURTON COMPANY

(a Delaware Corporation)
75-2677995

3600 Lincoln Plaza
500 N. Akard
Dallas, Texas 75201

Telephone Number - Area Code (214) 978-2600

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

Common stock, par value $2.50 per share:
Outstanding at July 24, 2002 - 436,351,938

Halliburton Company has amended disclosures on the calculation of our asbestos liability in order to utilize the third party expert's conclusion based on a 50-year period and five year claims history in the Hamilton, Rabinovitz & Alschuler, Inc.'s econometric study. There is no material difference in our asbestos liability or the related insurance receivables using the revised assumptions when compared to those assumptions originally used in the second quarter of 2002. Accordingly, no restatement of our original financial statements at June 30, 2002 is necessary. The sections of the Form 10-Q affected by the change are Management's Discussion and Analysis of Financial Condition and Results of Operations "Business Environment" - "Asbestos" and "Critical Accounting Policies" - "Loss Contingencies"; and our disclosure in Note 8 - "Commitments and Contingencies" under the heading "Asbestos study and the valuation of unresolved current and future asbestos claims, and related insurance receivables".

HALLIBURTON COMPANY

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

HALLIBURTON COMPANY
Condensed Consolidated Statements of Income
(Unaudited)
(Millions of dollars and shares except per share data)

	Three Months Ended June 30		
	2002	2001	20
Revenues:			
Services	$ 2,750	$ 2,812	$
Product sales	457	498	
Equity in earnings of unconsolidated affiliates	28	29	
Total revenues	$ 3,235	$ 3,339	$
Operating costs and expenses:			
Cost of services	$ 3,075	$ 2,512	$
Cost of sales	407	454	
General and administrative	97	101	
Gain on sale of joint venture	-	-	
Impairment on equity investment	61	-	
Total operating costs and expenses	$ 3,640	$ 3,067	$
Operating income (loss)	(405)	272	
Interest expense	(30)	(34)	
Interest income	12	6	
Foreign currency losses, net	(5)	(1)	
Other, net	(2)	-	
Income (loss) from continuing operations before income taxes, minority interest, and change in accounting method, net	(430)	243	
(Provision) benefit for income taxes	77	(98)	
Minority interest in net income of subsidiaries	(5)	(2)	
Income (loss) from continuing operations before change in accounting method, net	(358)	143	
Discontinued operations:			
Loss from discontinued operations, net of tax benefit of $19, $32, $34, and $17	(140)	(60)	
Gain on disposal of discontinued operations, net of tax of $0, $199, $0, and $199	-	299	
Income (loss) from discontinued operations	(140)	239	
Cumulative effect of change in accounting method, net	-	-	
Net income (loss)	$ (498)	$ 382	$

Basic income (loss) per share:			
Income (loss) from continuing operations before change in accounting method, net	$ (0.83)	$ 0.34	$ (
Loss from discontinued operations	(0.32)	(0.14)	(
Gain on disposal of discontinued operations	-	0.70	
Net income (loss)	$ (1.15)	$ 0.90	$ (
Diluted income (loss) per share:			
Income (loss) from continuing operations before change in accounting method, net	$ (0.83)	$ 0.33	$ (
Loss from discontinued operations	(0.32)	(0.14)	(
Gain on disposal of discontinued operations	-	0.70	
Net income (loss)	$ (1.15)	$ 0.89	$ (
Cash dividends per share	$ 0.125	$ 0.125	$
Basic average common shares outstanding	432	427	
Diluted average common shares outstanding	432	430	

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HALLIBURTON COMPANY
Condensed Consolidated Balance Sheets
(Unaudited)
(Millions of dollars and shares except per share data)

	June 30 2002	December 31 2001
Assets		
Current assets:		
Cash and equivalents	$ 383	$ 290
Receivables:		
Notes and accounts receivable, net	2,606	3,015
Unbilled work on uncompleted contracts	1,000	1,080
Total receivables	3,606	4,095
Inventories	808	787
Current deferred income taxes	126	154
Other current assets	253	247
Total current assets	5,176	5,573
Property, plant and equipment after accumulated depreciation of $3,329 and $3,281	2,692	2,669
Equity in and advances to related companies	568	551
Goodwill, net	725	720
Noncurrent deferred income taxes	512	410
Insurance for asbestos litigation claims	1,594	612
Other assets	720	431
Total assets	$ 11,987	$ 10,966

Liabilities and Shareholders' Equity		
Current liabilities:		
Short-term notes payable	$ 66	$ 44
Current maturities of long-term debt	215	81
Accounts payable	1,140	917
Accrued employee compensation and benefits	254	357
Advanced billings on uncompleted contracts	492	611
Deferred revenues	88	99
Income taxes payable	78	194
Reserves on uncompleted contracts	193	101
Other current liabilities	461	504
Total current liabilities	2,987	2,908
Long-term debt	1,264	1,403
Employee compensation and benefits	562	570
Asbestos litigation claims	2,196	737
Minority interest in consolidated subsidiaries	51	41
Other liabilities	672	555
Total liabilities	7,732	6,214
Shareholders' equity:		
Common shares, par value $2.50 per share - authorized 600 shares, issued 456 and 455 shares	1,141	1,138
Paid-in capital in excess of par value	296	298
Deferred compensation	(88)	(87)
Accumulated other comprehensive income	(201)	(236)
Retained earnings	3,742	4,327
	4,890	5,440
Less 20 and 21 shares of treasury stock, at cost	635	688
Total shareholders' equity	4,255	4,752
Total liabilities and shareholders' equity	$ 11,987	$ 10,966

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HALLIBURTON COMPANY
Condensed Consolidated Statements of Cash Flows
(Unaudited)
(Millions of dollars)

	Six Months Ended June 30	
	2002	2001
Cash flows from operating activities:		
Net income (loss)	$ (476)	$ 491
Adjustments to reconcile net income (loss) to net cash from operations:		
Loss (income) from discontinued operations	168	(261)
Depreciation, depletion and amortization	266	258
Provision (benefit) for deferred income taxes	(73)	50
Distributions from (advances to) related companies, net of		

equity in (earnings) losses	14	26
Change in accounting method, net	-	(1)
Gain on sale of joint venture	(108)	-
Gain on option component of joint venture sale	(3)	-
Impairment on equity investment	61	-
Asbestos reserve, net	477	95
Accrued special charges	-	(6)
Other non-cash items	72	20
Other changes, net of non-cash items:		
Receivables and unbilled work on uncompleted contracts	227	(346)
Sale of receivables	200	-
Inventories	(24)	(145)
Accounts payable	169	79
Other working capital, net	(239)	42
Other operating activities	(111)	42
Total cash flows from operating activities	620	344
Cash flows from investing activities:		
Capital expenditures	(404)	(344)
Sales of property, plant and equipment	54	39
(Acquisitions) dispositions of businesses, net	134	(139)
Investments - restricted cash	(188)	-
Other investing activities	(10)	(8)
Total cash flows from investing activities	(414)	(452)
Cash flows from financing activities:		
Payments on long-term borrowings	(4)	(9)
(Repayments) borrowings of short-term debt, net	14	(854)
Payments of dividends to shareholders	(109)	(107)
Proceeds from exercises of stock options	-	24
Payments to reacquire common stock	(2)	(8)
Other financing activities	-	(3)
Total cash flows from financing activities	(101)	(957)
Effect of exchange rate changes on cash	(12)	(12)
Net cash flows from discontinued operations	-	1,174
Increase in cash and equivalents	93	97
Cash and equivalents at beginning of period	290	231
Cash and equivalents at end of period	$ 383	$ 328
Supplemental disclosure of cash flow information:		
Cash payments during the period for:		
Interest	$ 53	$ 16
Income taxes	$ 98	$ 145
Non-cash investing and financing activities:		
Liabilities assumed in acquisitions of businesses	$ -	$ 18
Liabilities disposed of in dispositions of businesses	$ -	$ 430

HALLIBURTON COMPANY
Notes to Quarterly Financial Statements
(Unaudited)

Note 1. Management Representations

We employ accounting policies that are in accordance with generally accepted accounting principles in the United States of America. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect:

- the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements; and
- the reported amounts of revenues and expenses during the reporting period.

Ultimate results could differ from those estimates.

The accompanying unaudited condensed consolidated financial statements were prepared using generally accepted accounting principles for interim financial information, the instructions to Form 10-Q and applicable rules of Regulation S-X. Accordingly, these financial statements do not include all information or footnotes required by generally accepted accounting principles for complete financial statements and should be read together with our 2001 Annual Report on Form 10-K. All adjustments which are, in the opinion of management, of a normal recurring nature and are necessary for a fair presentation of the interim financial statements have been included. Prior period amounts have been reclassified to be consistent with the current presentation.

In our opinion, the condensed consolidated financial statements present fairly our financial position as of June 30, 2002, the results of our operations for the three and six months ended June 30, 2002 and 2001 and our cash flows for the six months then ended. The results of operations for the three and six months ended June 30, 2002 and 2001 may not be indicative of results for the full year.

Note 2. Business Segment Information

During the first quarter of 2002, we announced plans to restructure our businesses into two wholly-owned operating subsidiary groups. One group is focused on energy services and the other is focused on engineering and construction. As part of this restructuring, many support functions which were previously shared were moved into the two business groups. We also decided that the operations of Major Projects, Granherne and Production Services were best managed by our Kellogg Brown & Root subsidiary, or KBR, in the current business environment. These businesses were moved for management and reporting purposes from the Energy Services Group segment to the Engineering and Construction Group segment during the second quarter. All prior period segment results have been restated to reflect this change. Major Projects, which currently consists of the Barracuda-Caratinga project in Brazil, is now reported through the Offshore Operations product line, Granherne is now reported in the Onshore product line and Production Services is now reported under the Operations and Maintenance product line.

The tables below present information on our continuing operations business segments on a comparable basis.

	Three Months Ended June 30		Six Months Ended June 30	
Millions of dollars	2002	2001	2002	2001
Revenues:				
Energy Services Group	$ 1,756	$ 2,008	$ 3,445	$ 3,800
Engineering and Construction Group	1,479	1,331	2,797	2,683
Total	$ 3,235	$ 3,339	$ 6,242	$ 6,483

Operating income (loss):				
Energy Services Group	$ 70	$ 268	$ 239	$ 457
Engineering and Construction Group	(450)	21	(508)	48
General corporate	(25)	(17)	(13)	(35)
Total	$ (405)	$ 272	$ (282)	$ 470

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Energy Services Group. The Energy Services Group provides a wide range of discrete services and products and integrated solutions to customers for the exploration, development, and production of oil and gas. The customers for this segment are major, national and independent oil and gas companies. This segment consists of:

- Halliburton Energy Services provides oilfield services and products including discrete products and services and integrated solutions for oil and gas exploration, development and production throughout the world. Products and services include pressure pumping equipment and services, logging and perforating, drilling systems and services, drilling fluids systems, drill bits, specialized completion and production equipment and services, well control, and integrated solutions;
- Landmark Graphics provides integrated exploration and production software information systems, data management services, professional services to the petroleum industry and reservoir description; and
- Other product service lines provide installation and servicing of subsea facilities and pipelines, manufacture of flexible pipe for offshore applications, and pipecoating services. In January 2002 we sold our interest in European Marine Contractors Ltd., a 50%-owned joint venture that provided pipeline services for offshore customers. See Note 3.

Engineering and Construction Group. The Engineering and Construction Group provides engineering, procurement, construction, project management, and facilities operation and maintenance for oil and gas and other industrial and governmental customers. The Engineering and Construction Group, operating as KBR, includes the following five product lines:

- Onshore operations comprise engineering and construction activities, including liquefied natural gas, ammonia, crude oil refineries, and natural gas plants;
- Offshore operations include specialty offshore deepwater engineering and marine technology and worldwide fabrication capabilities;
- Government operations provide operations, maintenance and logistics activities for government facilities and installations;
- Operations and maintenance services include plant operations, maintenance and start up services for both upstream and downstream oil, gas and petrochemical facilities as well as operations, maintenance and logistics services for the power, commercial and industrial markets; and
- Infrastructure provides civil engineering, consulting and project management services.

Intersegment revenues included in the revenues of the business segments are immaterial. Our equity in pretax earnings and losses of unconsolidated affiliates that are accounted for on the equity method is included in revenues and operating income of the applicable segment.

Note 3. Acquisitions and Dispositions

Subsea 7. In May 2002, we contributed a portion of our Halliburton Subsea assets to a newly formed company, Subsea 7, Inc. We contributed assets with a carrying value of approximately $75 million. We own 50% of Subsea 7 and account for this investment using the equity method. The remaining 50% is owned by DSND Subsea ASA.

Magic Earth acquisition. In November 2001, we acquired Magic Earth, Inc., a leading 3-D visualization and interpretation technology company with broad applications in the area of data interpretation. Under the agreement, Halliburton issued 4.2 million shares of common stock from treasury stock valued at $100 million. Magic Earth became a wholly-owned subsidiary and is reported within our Energy Services Group. We recorded intangible assets of $19 million and goodwill of $71 million, all of which is nondeductible for tax purposes. The intangible assets will be amortized based on a five year life.

PES acquisition. In February 2000, we acquired the remaining 74% of the shares of PES (International) Limited that we did not already own. PES had developed technology that complemented Halliburton Energy Services' real-time reservoir solutions. To acquire the remaining 74% of PES, we issued 1.2 million shares of Halliburton common stock and rights that resulted in the issuance of 2.1 million additional shares of Halliburton common stock. We recorded $115 million of goodwill in connection with acquiring the remaining 74%.

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During the second quarter of 2001, we contributed the majority of PES' assets and technologies, including $130 million of goodwill associated with the purchase of PES, to a newly formed joint venture with Shell Technology Ventures B.V., WellDynamics. We received $39 million in cash as an equity equalization adjustment. The remaining assets and goodwill of PES relating to completions and well intervention products have been combined with our existing completions product service line. We own 50% of WellDynamics and account for this investment using the equity method.

PGS Data Management acquisition. In March 2001, we acquired the PGS Data Management division of Petroleum Geo-Services ASA (PGS) for $164 million. The agreement also calls for Landmark to provide, for a fee, strategic data management and distribution services to PGS for three years. We recorded intangible assets of $14 million and goodwill of $149 million, $9 million of which is nondeductible for tax purposes.

European Marine Contractors Ltd. disposition. In January 2002, we sold our 50% interest in European Marine Contractors Ltd., an unconsolidated joint venture in the Energy Services Group, to our joint venture partner, Saipem. At the date of sale, we received $115 million in cash and a contingent payment option valued at $16 million resulting in a pretax operating income gain of $108 million. The contingent payment option was based on a formula linked to the Oil Service Index performance. In February 2002, we exercised our option receiving an additional $19 million and recorded a pretax gain of $3 million in Other, net in the income statement as a result of the increase in value of this option. The total transaction resulted in an after-tax gain of $68 million, or $0.16 per diluted share.

Dresser Equipment Group divestiture. In April 2001, we disposed of the remaining businesses in the Dresser Equipment Group. See Note 5.

Note 4. Restricted Cash

At June 30, 2002, we had restricted cash of $188 million included in Other assets. Restricted cash in Other assets mainly consists of a $106 million deposit that collateralizes an appeal bond for a patent infringement judgement on appeal and $56 million as collateral for potential future insurance claim reimbursements. Also included in restricted cash is $26 million primarily related to cash collateral agreements for outstanding letters of credit for various construction projects. In the 2002 first quarter, the $26 million was included as Other current assets on the balance sheet. As the projects are considered long-term in nature, we have reclassified this amount to Other assets on the balance sheet in the second quarter of 2002.

Note 5. Discontinued Operations

In late 1999 and early 2000 we sold our interest in two joint ventures which were a significant portion of our Dresser Equipment Group. These sales prompted a strategic review of the remaining businesses within the Dresser Equipment Group. As a result of this review, we determined that these remaining businesses did not closely fit with our core businesses, long-term goals and strategic objectives. In April 2000, our Board of Directors approved plans to sell all the remaining businesses within the Dresser Equipment Group. We sold these businesses on April 10, 2001. As part of the terms of the transaction, we retained a 5.1% equity interest in the Dresser Equipment Group, which has been renamed Dresser, Inc. In the second quarter of 2001, we recognized a pretax gain on this sale of $498 million ($299 million after-tax). The financial results of the Dresser Equipment Group through March 31, 2001 are presented as discontinued operations in our financial statements.

During the second quarter of 2002, in connection with our asbestos econometric study, we recorded a pretax expense of $153 million, $123 million after-tax, to discontinued operations for existing and future asbestos claims and defense costs related to previously disposed businesses, net of anticipated insurance recoveries. See Note 8. We also recorded pretax expense of $6 million associated with the Harbison-Walker bankruptcy filing. In addition, based upon the impact of certain second quarter items, we adjusted our 2002 estimated effective tax rate for discontinued operations by recording an $11 million tax provision in the second quarter of 2002.

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Loss from Discontinued Operations Millions of dollars	Three Months Ended June 30 2002	Three Months Ended June 30 2001	Six Months Ended June 30 2002	Six Months Ended June 30 2001
Revenues	$ -	$ -	$ -	$ 359
Operating income	$ -	$ -	$ -	$ 37
Asbestos litigation claims, net of insurance recoveries	(159)	(92)	(202)	(92)
Tax benefit	19	32	34	17
Net loss	$ (140)	$ (60)	$ (168)	$ (38)

Note 6. Receivables and Unapproved Claims

Our receivables are generally not collateralized. See Note 12. With the exception of claims and change orders that are in the process of being negotiated with customers, unbilled work on uncompleted contracts generally represents work currently billable or billable upon achievement of specific contractual milestones.

Recording of profits and losses on long-term contracts requires an estimate of the total profit or loss over the life of each contract. This estimate requires consideration of contract revenue, change orders and claims; less costs incurred and estimated costs to complete. Losses on contracts are recorded in full in the period they are identified. Profits are recorded based upon the total estimated contract profit times the current percentage complete for the contract.

When calculating the amount of total profit or loss on a long-term contract, we include unapproved claims as revenue when the collection is deemed probable based upon the four criteria for recognizing unapproved claims under Statement of Position 81-1 "Accounting for Performance of Construction-Type and Certan Production-Type Contracts". In most cases, the probable unapproved claims included in determining contract profit or loss are less than the actual claim that will be or has been presented to the customer.

When recording the revenue and the associated unbilled receivable for unapproved claims, we only accrue an amount equal to the costs incurred related to probable unapproved claims. Therefore, the difference between the probable unapproved claims included in determining contract profit or loss and the unapproved claims recorded in unbilled work on uncompleted contracts relates to forecasted costs which have not been incurred. The amounts included in determining the profit or loss on contracts, and the amount booked to unbilled work on uncompleted contracts for each period is as follows:

Millions of dollars	June 30 2002	December 31 2001
Probable unapproved claims (included in determining contract profit or loss)	$ 193	$ 137
Unapproved claims in unbilled work on uncompleted contracts	$ 135	$ 102

The claims at June 30, 2002 listed in the above table relate to eight contracts most of which are complete or substantially complete. We are actively engaged in claims negotiation with the customer in all but one case, and in that case we are initiating the arbitration process. The probable unapproved claim related to the arbitration process is $5 million. The largest claim included relates to an offshore field development contract in Brazil which is approximately 43% complete as of the end of the second quarter of 2002. The probable unapproved claims included in determining this contract's loss was $101 million at June 30, 2002 and $43 million at December 31, 2001. As the claim for this contract most likely will not be settled withn one year, amounts in unbilled work on uncompleted contracts of $44 million at June 30, 2002 and $10 million at December 31, 2001 included in the table above have been recorded to long-term unbilled work on uncompleted contracts which is included in Other assets on the balance sheet. All other claims included in the tabel above have been recorded to Unbilled work on uncompleted contracts included in the Total receivables amount on the balance sheet.

In addition, our unconsolidated related companies include probable unapproved claims as revenue to determine the amount of profit or loss for their contracts. As we account for these as equity investments, we only record our equity percentage of the net income from the unapproved claims. Amounts for unapproved claims from our related companies are included in equity in and advances to related companies and totaled $7 million at June 30, 2002 and $0.3 million at December 31, 2001.

Note 7. Inventories

Inventories at June 30, 2002 and December 31, 2001 are composed of the following:

	June 30	December 31

Millions of dollars	2002	2001
Finished products and parts	$ 552	$ 520
Raw materials and supplies	184	192
Work in process	72	75
Total	$ 808	$ 787

Included in the table above are inventories on the last-in, first-out method of $50 million at June 30, 2002 and $54 million at December 31, 2001. If the average cost method had been used, total inventories would have been about $20 million higher than reported at June 30, 2002 and December 31, 2001.

Note 8. Commitments and Contingencies

Asbestos litigation. Several of our subsidiaries, particularly DII Industries, LLC (See Note 13) and Kellogg Brown & Root, Inc., are defendants in a large number of asbestos-related lawsuits. The plaintiffs allege injury as a result of exposure to asbestos in products manufactured or sold by former divisions of DII Industries, LLC or in materials used in construction or maintenance projects of Kellogg Brown & Root, Inc. These claims are in three general categories:

- refractory claims;
- other DII Industries, LLC claims; and
- construction claims.

Refractory claims. Asbestos was used in a small number of products manufactured or sold by Harbison-Walker Refractories Company, which DII Industries, LLC acquired in 1967. Harbison-Walker was spun-off by DII Industries, LLC in July, 1992. At that time, Harbison-Walker assumed liability for asbestos claims filed after the spin-off and it agreed to defend and indemnify DII Industries, LLC from liability for those claims. DII Industries, LLC retained responsibility for all asbestos claims pending as of the date of the spin-off. After the spin-off, DII Industries, LLC and Harbison-Walker jointly negotiated and entered into coverage-in-place agreements with a number of insurance companies. Those agreements provide DII Industries, LLC and Harbison-Walker access to the same insurance coverage to reimburse them for defense costs, settlements and court judgments they pay to resolve refractory asbestos claims.

As of June 30, 2002, there were approximately 7,000 open and unresolved pre-spin-off refractory claims against DII Industries, LLC. In addition, there were approximately 139,000 post spin-off claims that name DII Industries, LLC as a defendant. DII Industries, LLC has taken up the defense of unsettled post spin-off refractory claims that name it as a defendant in order to prevent Harbison-Walker from unnecessarily eroding the insurance coverage both companies access for these claims. These claims are now stayed in the Harbison-Walker bankruptcy proceeding.

Other DII Industries, LLC claims. As of June 30, 2002, there were approximately 128,000 open and unresolved claims alleging injuries from asbestos used in other products formerly manufactured by DII Industries, LLC. Most of these claims involve gaskets and packing materials used in pumps and other industrial products.

Construction claims. Our Engineering and Construction Group includes engineering and construction businesses formerly operated by The M.W. Kellogg Company and Brown & Root, Inc., now combined as Kellogg Brown & Root, Inc. As of

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June 30, 2002, there were approximately 38,000 open and unresolved claims alleging injuries from asbestos in materials used in construction and maintenance projects, most of which were conducted by Brown & Root, Inc.

Approximately 1,000 of these claims are asserted against The M.W. Kellogg Company. We believe that Kellogg Brown & Root has a good defense to these claims, and a prior owner of The M.W. Kellogg Company provides Kellogg Brown & Root a contractual indemnification for claims against The M.W. Kellogg Company.

Harbison-Walker Chapter 11 bankruptcy. On February 14, 2002, Harbison-Walker filed a voluntary petition for reorganization under Chapter 11 of the United States Bankruptcy Code in the Bankruptcy Court in Pittsburgh, Pennsylvania. In its bankruptcy-related filings, Harbison-Walker said that it would seek to utilize Sections 524(g) and 105 of the Bankruptcy Code to propose and have confirmed a plan of reorganization that would provide for distributions for all legitimate, pending and future asbestos claims asserted directly against it or asserted against DII Industries, LLC for which Harbison-Walker is required to indemnify and defend DII Industries, LLC. If such a plan of reorganization is confirmed, all pending and future refractory asbestos claims against Harbison-Walker or DII Industries, LLC would be channeled to a Section 524(g)/105 trust for resolution and payment. In order for a trust to be confirmed, at least a majority of the equity ownership of Harbison-Walker would have to be contributed to the trust. We also anticipate a significant financial contribution will also be required to obtain the necessary approvals for the trust. Creation of a trust would also require the approval of 75% of the asbestos claimant creditors of Harbison-Walker.

In connection with the Chapter 11 filing by Harbison-Walker, the Bankruptcy Court issued a temporary restraining order staying all further litigation of more than 200,000 asbestos claims currently pending against DII Industries, LLC in numerous courts throughout the United States. A number of claimants oppose that stay, and filed motions seeking to have the stay terminated. On April 4, 2002, the Bankruptcy Court heard argument on these motions and kept the stay in effect until at least 11 days after the Bankruptcy Court rules on the claimants' motions. When the Bankruptcy Court rules, it may issue a preliminary injunction continuing the stay or it may modify or dissolve the stay as it applies to DII Industries, LLC. It is also possible that the Bankruptcy Court will schedule future hearings while continuing or modifying the stay. At present, there is no assurance that a stay will remain in effect, that a plan of reorganization will be proposed or confirmed, or that any plan that is confirmed will provide relief to DII Industries, LLC. DII Industries, LLC may make a contribution to a trust in order to achieve a confirmed plan. If a plan is not confirmed that provides relief to DII Industries, LLC, it will be required to defend all open claims in the courts in which they have been filed, possibly with reduced access to the insurance shared with Harbison-Walker.

The stayed asbestos claims are those covered by insurance that DII Industries, LLC and Harbison-Walker each access to pay defense costs, settlements and judgments attributable to both refractory and non-refractory asbestos claims. The stayed claims include approximately 139,000 post-1992 spin-off refractory claims, 7,000 pre-spin-off refractory claims and approximately 110,000 other types of asbestos claims pending against DII Industries, LLC. Approximately 51,000 of the claims in the third category are claims made against DII Industries, LLC based on more than one ground for recovery and the stay affects only the portion of the claim covered by the shared insurance. The stay prevents litigation from proceeding while the stay is in effect and also prohibits the filing of new claims. One of the purposes of the stay is to allow Harbison-Walker and DII Industries, LLC time to develop and propose a plan of reorganization.

DII Industries, LLC agreed to provide up to $35 million of debtor-in-possession financing to Harbison-Walker during the pendency of the Chapter 11 proceeding of which $5 million was advanced during the first quarter of 2002. On February 14, 2002, DII Industries, LLC also paid $40 million to Harbison-Walker's United States parent holding company, RHI Refractories Holding Company. This payment was made when Harbison-Walker filed its bankruptcy petition and was charged to discontinued operations in our financial statements in the first quarter of 2002. Harbison-Walker's failure to fulfill its indemnity obligations, and its excessive erosion of the insurance coverage, required DII Industries, LLC to assist Harbison-Walker in its bankruptcy proceeding in order to protect the shared insurance from dissipation. This insurance will be needed if a trust is to be worked out with the asbestos claimants. The payment to RHI Refractories led RHI Refractories to forgive intercompany debt owed to it by Harbison-Walker, thus increasing the assets of Harbison-Walker. DII Industries, LLC will pay another $35 million to RHI Refractories if a plan of reorganization acceptable to DII Industries, LLC is proposed in the bankruptcy proceedings. A further $85 million will be paid to RHI Refractories if a plan acceptable to DII Industries, LLC is approved by 75% of the Harbison-Walker asbestos claimant creditors and confirmed by the Bankruptcy Court.

As a result of DII Industries, LLC's continuing settlement negotiations with the Asbestos Claimants Committee, or ACC, which was formed as part of the Harbison-Walker bankruptcy, and certain law firms that represent a substantial percentage of the plaintiffs that have asserted Harbison-Walker-related claims against DII Industries, LLC, the temporary restraining order originally entered by the Bankruptcy Court on February 14, 2002 has been consensually extended until at least September 18, 2002. On September 18, 2002, DII Industries, LLC and the ACC will present a status report to the Bankruptcy Court. To the extent that the settlement negotiations continue to make progress, DII Industries, LLC anticipates that the ACC will consent to have the temporary restraining order extended for an additional period of time.

DII Industries, LLC's settlement negotiations with the law firms that represent a substantial majority of plaintiffs that have asserted Harbison-Walker-related claims against DII Industries, LLC have not been limited to Harbison-Walker-related claims. Rather, DII Industries, LLC is exploring with these law firms the possibility of resolving, on a global basis, all of the refractory asbestos claims, all of the other DII Industries, LLC asbestos claims (including claims related to historic DII Industries, LLC manufacturing operations and Worthington Corporation) and all of the construction asbestos-related claims, including all future asbestos-related claims. These broader negotiations involve difficult and complex issues. At this time there is no assurance that DII Industries, LLC will be able to reach an acceptable agreement. We expect that these negotiations will continue for some time before we will even be able to make a judgment as to whether a global settlement is reasonably likely.

Asbestos insurance coverage. DII Industries, LLC has substantial insurance that reimburses it for portions of the costs incurred defending asbestos claims, as well as amounts paid to settle claims and court judgments. This coverage is provided by a large number of insurance policies written by dozens of insurance companies. The insurance companies wrote the coverage over a period of more than 30 years for DII Industries, LLC, its predecessors or its subsidiaries and their predecessors. Large amounts of this coverage are now subject to coverage-in-place agreements that resolve issues concerning amounts and terms of coverage. The amount of insurance available to DII Industries, LLC and its subsidiaries depends on the nature and time of the alleged exposure to asbestos, the specific subsidiary against which an asbestos claim is asserted and other factors.

Refractory claims insurance. DII Industries, LLC has approximately $2.1 billion in aggregate limits of insurance coverage for refractory asbestos claims, of which over one-half is with Equitas or other London-based insurance companies. Most of this insurance is shared with Harbison-Walker. Many of the issues relating to the majority of this coverage have been resolved by coverage-in-place agreements with dozens of companies, including Equitas and other London-based insurance companies. Recently, however, Equitas and other London-based companies have attempted to impose new restrictive documentation requirements on DII Industries, LLC and other insureds. Equitas and the other London-based companies have stated that the new requirements are part of an effort to limit payment of settlements to claimants who are truly impaired by exposure to asbestos and can identify the product or premises that caused their exposure.

On March 21, 2002, Harbison-Walker filed a lawsuit in the United States Bankruptcy Court for the Western District of Pennsylvania in its Chapter 11 bankruptcy proceeding. This lawsuit is substantially similar to DII Industries, LLC's lawsuit filed in Texas State Court in 2001 and seeks, among other relief, a determination as to the rights of DII Industries, LLC and Harbison-Walker to the shared general liability insurance. The lawsuit also seeks damages against certain insurers for breach of contract and bad faith, and a declaratory judgment concerning the insurers' obligations under the shared insurance. Although DII Industries, LLC is also a defendant in this lawsuit, it has

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asserted its own claim to coverage under the shared insurance and is cooperating with Harbison-Walker to secure both companies' rights to the shared insurance. The Bankruptcy Court has ordered the parties to this lawsuit to engage in non-binding mediation. The first mediation session was held on July 26, 2002 and additional sessions are scheduled to take place, provided the Bankruptcy Court's mediation order remains in effect, in September, October and November 2002. Given the early stages of these negotiations, DII Industries, LLC cannot predict whether a negotiated resolution of this dispute will occur or, if such a resolution does occur, the precise terms of such a resolution.

Prior to the Harbison-Walker bankruptcy, on August 7, 2001, DII Industries, LLC filed a lawsuit in Dallas County, Texas, against a number of these insurance companies asserting DII Industries, LLC rights under an existing coverage-in-place agreement and under insurance policies not yet subject to coverage-in-place agreements. The coverage-in-place agreements allow DII Industries, LLC to enter into settlements for small amounts without requiring claimants to produce detailed documentation to support their claims, when DII Industries, LLC believes the settlements are an effective claims management strategy. DII Industries, LLC believes that the new documentation requirements are inconsistent with the current coverage-in-place agreements and are unenforceable. The insurance companies that DII Industries, LLC has sued have not refused to pay larger claim settlements where documentation is obtained or where court judgments are entered. Also, they continue to pay previously agreed to amounts of defense costs that DII Industries, LLC incurs defending refractory asbestos claims. All of the asbestos claims to which this insurance covers are currently stayed by the Harbison-Walker bankruptcy, and consequently the breach of the coverage-in-place agreements is currently having no impact upon DII Industries, LLC.

On May 10, 2002, the London-based insuring entities and companies removed DII Industries, LLC's Dallas County State Court Action to the United States District Court for the Northern District of Texas alleging that federal court jurisdiction existed over the case because it is related to the Harbison-Walker bankruptcy. DII Industries, LLC has filed an opposition to that removal and has asked the federal court to remand the case back to the Dallas County state court. On June 12, 2002, the London-based insuring entities and companies filed a motion to transfer the case to the federal court in Pittsburgh, Pennsylvania. DII Industries, LLC has filed an opposition to that motion to transfer. The federal court in Dallas has yet to rule on any of these motions. Regardless of the outcome of these motions, because of the similar insurance coverage lawsuit filed by Harbison-Walker in its bankruptcy proceeding, it is unlikely that DII Industries, LLC's case will proceed independently of the bankruptcy.

Other DII Industries, LLC claims insurance. DII Industries, LLC has substantial insurance to cover other non-refractory asbestos claims. Two coverage-in-place agreements cover DII Industries, LLC for companies or operations that DII Industries, Inc., either acquired or operated prior to November 1, 1957. Asbestos claims that are covered by these agreements are currently stayed by the Harbison-Walker bankruptcy because the majority of this coverage also applies to refractory claims and is shared with Harbison-Walker.

Other insurance coverage is provided by a number of different policies that DII Industries, LLC acquired rights to access when it acquired businesses from other companies. Three coverage-in-place agreements provide reimbursement for asbestos claims made against DII Industries, LLC former Worthington pump division. There is also other substantial insurance coverage with approximately $2.0 billion in aggregate limits that has not yet been reduced to coverage-in-place agreements.

On August 28, 2001, DII Industries, LLC filed a lawsuit in the 192nd Judicial District of the District Court for Dallas County, Texas against certain London-based insuring entities that issued insurance policies that provide coverage to DII Industries, LLC for asbestos-related liabilities arising out of the historical operations of Worthington Corporation or its successors. This lawsuit raises essentially the same issue as to the documentation requirements as the August 7, 2001 Harbison-Walker lawsuit filed in the same court. The London-based insuring entities filed a motion in that case seeking to compel the parties to binding arbitration. The trial court denied that motion and the London-based insuring entities appealed that decision to the state appellate court. The state appellate court denied the appeal and the case should now proceed to resolution in the trial court.

A significant portion of the insurance coverage applicable to Worthington claims is alleged by Federal-Mogul Products, Inc. to be shared with it. In 2001, Federal-Mogul Products, Inc. and a large number of its affiliated companies filed a voluntary petition for reorganization under Chapter 11 of the Bankruptcy Code in the Bankruptcy Court in Wilmington, Delaware.

In response to Federal-Mogul's allegations, on December 7, 2001, DII Industries, LLC filed a lawsuit in the Delaware Bankruptcy Court asserting its rights to insurance coverage under historic general liability policies issued to Studebaker-Worthington, Inc. and its successor for asbestos-related liabilities arising from, among other operations, Worthington's and its successors' historic operations. This lawsuit also seeks a judicial declaration concerning the competing rights of DII Industries, LLC and Federal-Mogul, if any, to this insurance coverage. DII Industries, LLC recently filed a second amended complaint in that lawsuit and the parties are now beginning the discovery process.

At the same time, DII Industries, LLC filed its insurance coverage action in the Federal-Mogul bankruptcy, DII Industries, LLC also filed a second lawsuit in which it has filed a motion for preliminary injunction seeking a stay of all Worthington asbestos-related lawsuits against DII Industries, LLC that are scheduled for trial within the six months following the filing of the motion. The stay that DII Industries, LLC seeks, if granted, would remain in place until the competing rights of DII Industries, LLC and Federal-Mogul to the allegedly shared insurance are resolved. The Court has yet to schedule a hearing on DII Industries, LLC motion for preliminary injunction.

A number of insurers who have agreed to coverage-in-place agreements with DII Industries, LLC have suspended payment under the shared Worthington policies until the Federal-Mogul Bankruptcy Court resolves the insurance issues. Consequently, the effect of the Federal-Mogul bankruptcy on DII Industries, LLC's rights to access this shared insurance is uncertain.

Construction claims insurance. Nearly all of our construction asbestos claims relate to Brown & Root, Inc. operations before the 1980s. Our primary insurance coverage for these claims was written by Highlands Insurance Company during the time it was one of our subsidiaries. Highlands was spun-off to our shareholders in 1996. On April 5, 2000, Highlands filed a lawsuit against us in the Delaware Chancery Court. Highlands asserted that the insurance it wrote for Brown & Root, Inc. that covered construction asbestos claims was terminated by agreements between Halliburton and Highlands at the time of the 1996 spin-off. In March 2001, the Chancery Court ruled that a termination did occur and that Highlands was not obligated to provide coverage for Brown & Root, Inc.'s asbestos claims. This decision was affirmed by the Delaware Supreme Court on

March 13, 2002. As a result of this ruling, we wrote-off approximately $35 million in accounts receivable for amounts paid for claims and defense costs and $45 million of accrued receivables in relation to estimated insurance recoveries claims settlements from Highlands in the first quarter 2002. In addition, we dismissed the April 24, 2000 lawsuit we filed against Highlands in Harris County, Texas.

As a consequence of the Delaware Supreme Court's decision, Kellogg Brown & Root no longer has primary insurance coverage from Highlands for asbestos claims. However, Kellogg Brown & Root has significant excess insurance coverage. The amount of this excess coverage that will reimburse us for an asbestos claim depends on a variety of factors. On March 20, 2002, Kellogg Brown & Root filed a lawsuit in the 172nd Judicial District of the District Court of Jefferson County, Texas, against Kellogg Brown & Root's historic insurers that issued these excess insurance policies. In the lawsuit, Kellogg Brown & Root seeks to establish the specific terms under which it can seek reimbursement for costs it incurs in settling and defending asbestos claims from its historic construction operations. Until this lawsuit is resolved, the scope of the excess insurance will remain uncertain. We do not expect the excess insurers will reimburse us for asbestos claims until this lawsuit is resolved.

Significant asbestos judgments on appeal. During 2001, there were several adverse judgments in trial court proceedings that are in various stages of the appeal process. All of these judgments concern asbestos claims involving Harbison-Walker refractory products. Each of these appeals, however, has been stayed by the Bankruptcy Court in the Harbison-Walker Chapter 11 bankruptcy.

On November 29, 2001, the Texas District Court in Orange, Texas, entered judgments against DII Industries, LLC on a $65 million jury verdict rendered in September 2001 in favor of five plaintiffs. The $65 million amount includes $15 million of a $30 million judgment against DII Industries, LLC and another defendant. DII Industries, LLC is jointly and severally liable for $15 million in addition to $65 million if the other defendant does not pay its share of this judgment. We believe that during the trial the court committed numerous errors, including prohibiting DII Industries, LLC from presenting evidence that the alleged illness of the plaintiffs was caused by products of other companies that had previously settled with the plaintiffs. We intend to appeal this judgment and believe that the Texas appellate courts will ultimately reverse this judgment.

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On November 29, 2001, the same District Court in Orange, Texas, entered three additional judgments against DII Industries, LLC in the aggregate amount of $35.7 million in favor of 100 other asbestos plaintiffs. These judgments relate to an alleged breach of purported settlement agreements signed early in 2001 by a New Orleans lawyer hired by Harbison-Walker, which had been defending DII Industries, LLC pursuant to the agreement by which Harbison-Walker was spun-off by DII Industries, LLC in July 1992. These settlement agreements expressly bind Harbison-Walker Refractories Company as the obligated party, not DII Industries, LLC. DII Industries, LLC intends to appeal these three judgments on the grounds that it was not a party to the settlement agreements and it did not authorize anyone to settle on its behalf. We believe that these judgments are contrary to applicable law and will be reversed.

On December 5, 2001, a jury in the Circuit Court for Baltimore City, Maryland, returned verdicts against DII Industries, LLC and other defendants following a trial involving refractory asbestos claims. Each of the five plaintiffs alleges exposure to Harbison-Walker products. DII Industries, LLC portion of the verdicts was approximately $30 million. DII Industries, LLC believes that the trial court committed numerous errors and that the trial evidence did not support the verdicts. The trial court has entered judgment on these verdicts. DII Industries, LLC intends to appeal the judgment to the Maryland Supreme Court where we expect the judgment will be significantly reduced, if not totally reversed.

On October 25, 2001, in the Circuit Court of Holmes County, Mississippi, a jury verdict of $150 million was rendered in favor of six plaintiffs against DII Industries, LLC and two other companies. DII Industries, LLC share of the verdict was $21.3 million. The award was for compensatory damages. The jury did not award any punitive damages. The trial court has entered judgment on the verdict. We believe there were serious errors during the trial and we intend to appeal this judgment to the Mississippi Supreme Court. We believe the judgment will ultimately be reversed because there was a total lack of evidence that the plaintiffs were exposed to a Harbison-Walker product or that they suffered compensatory damages. Also, there were procedural errors in the selection of the jury.

Asbestos claims history. Since 1976, approximately 525,000 asbestos claims have been filed against us. Almost all of these claims have been made in separate lawsuits in which we are named as a defendant along with a number of other defendants, often exceeding 100 unaffiliated defendant companies in total. During the second quarter of 2002, we received approximately 26,000 new claims and we closed approximately 7,000 claims. The number of open claims pending against us at the end of the second quarter of 2002, at the end of the first quarter of 2002, at the end of each quarter of 2001 and at the end of 2000 is as follows:

Period Ending	Total Open Claims
June 30, 2002	312,000
March 31, 2002	292,000
December 31, 2001	274,000
September 30, 2001	146,000
June 30, 2001	145,000
March 31, 2001	129,000
December 31, 2000	117,000

The claims include approximately 139,000 at June 30, 2002, 133,000 at March 31, 2002 and 125,000 at December 31, 2001 of post spin-off Harbison-Walker refractory related claims that name DII Industries, LLC as a defendant.

We manage asbestos claims to achieve settlements of valid claims for reasonable amounts. When reasonable settlement is not possible, we contest claims in court. Since 1976, we have closed approximately 214,000 claims through settlements and court proceedings at a total cost of approximately $173 million. We have received or expect to receive from our insurers all but approximately $72 million of this cost, resulting in an average net cost per closed claim of about $336.

Asbestos study and the valuation of unresolved current and future asbestos claims, and related insurance receivables. DII Industries, LLC retained Dr. Francine F. Rabinovitz of Hamilton, Rabinovitz & Alschuler, Inc. to estimate the probable number and value, including defense costs, of unresolved current and future asbestos-related bodily injury claims asserted against DII Industries, LLC and its subsidiaries. Dr. Rabinovitz is a nationally renowned expert in conducting such analyses, has been involved in a number of asbestos-related and other toxic tort-related valuations of current and future liabilities, has served as the expert for two representatives of future claimants in asbestos related bankruptcies and has had her valuation methodologies accepted by numerous courts. Further, the methodology utilized by Dr. Rabinovitz is the same methodology that is utilized by the expert who is routinely retained by the asbestos claimants committee in asbestos-related bankruptcies. Dr. Rabinovitz estimated the probable number and value of unresolved current and future asbestos-related bodily injury claims asserted against DII Industries, LLC and its subsidiaries over a 50 year period.

In the past, we have only provided for known outstanding claims as we did not have sufficient information to make a reasonable estimate of future asbestos claims liability. However, as a result of Dr. Rabinovitz's analysis, we are now in a position to accrue not only for known open claims, but also for the projected costs to resolve asbestos claims through 2052.

The methodology utilized by Dr. Rabinovitz to project DII Industries, LLC's and its subsidiaries' asbestos-related liabilities and defense costs relied upon and included:

- an analysis of DII Industries, LLC's, Kellogg, Brown & Root, Inc.'s and Harbison-Walker Refractories Company's historical asbestos settlements and defense costs to develop average settlement values and average defense costs for specific asbestos-related diseases and for the specific business operation or entity allegedly responsible for the asbestos-related diseases;
- an analysis of DII Industries, LLC's, Kellogg, Brown & Root, Inc.'s and Harbison-Walker Refractories Company's pending inventory of asbestos-related claims by specific asbestos-related diseases and by the specific business operation or entity allegedly responsible for the asbestos-related disease;

- an analysis of the claims filing history for asbestos-related claims against DII Industries, LLC, Kellogg, Brown & Root, Inc. and Harbison-Walker Refractories Company since January 2000 (two-year claims history) and alternatively since January 1997 (five-year claims history) by specific asbestos-related disease and by business operation or entity allegedly responsible for the asbestos-related disease;

- an analysis of the population likely to have been exposed or claim exposure to products manufactured by DII Industries, LLC, its predecessors and Harbison-Walker or to Brown & Root construction and renovation projects; and
- epidemiological studies to estimate the number of people who might allege exposure to products manufactured by DII Industries LLC, its predecessors and Harbison-Walker or to Brown & Root construction and renovation projects that would be likely to develop asbestos-related diseases.

Dr. Rabinovitz's estimates are based on historical data supplied by DII Industries, LLC, Kellogg, Brown & Root, Inc. and Harbison-Walker and publicly available studies, including annual surveys by the National Institutes of Health concerning the incidence of mesothelioma deaths. In her analysis, Dr. Rabinovitz projected that the elevated and historically unprecedented rate of claim filings of the last several years, especially as expressed by the ratio of nonmalignant claim filings to malignant claim filings, would continue into the future for 5 more years. After that, Dr. Rabinovitz projected that the ratio of nonmalignant claim filings to malignant claim filings will gradually decrease for a 10 year period ultimately returning to the historical claiming rate and claiming ratio. In making her calculation Dr. Rabinovitz alternately assumed a somewhat lower rate of claim filings, based on an average of the last five years of claims experience, would continue into the future for five more years and decrease thereafter.

Other important assumptions utilized in Dr. Rabinovitz's estimates, which we relied upon in making our accrual are:

- an assumption that there will be no legislative or other systemic changes to the tort system;

- that the Company will continue to aggressively defend against asbestos claims made against the Company; and
- an inflation rate of 3% annually for settlement payments and an inflation rate of 4% annually for defense costs.

Based upon her analysis, Dr. Rabinovitz estimated DII Industries, LLC's total, undiscounted asbestos liabilities, including defense costs, through 2052 to be within a range from $2.2 billion to $3.5 billion. As of June 30, 2002, we do not believe there is a better amount within the expert's range and, therefore, we based our estimated accrual for asbestos liability on the low-end of the expert's range, or $2.2 billion, in accordance with SFAS 5 and related interpretations (which includes payments related to the approximately 312,000 claims currently pending).

If we had adjusted our accrual for asbestos liabilities for current and future asbestos claims up to the high-end of the expert's range, or $3.5 billion, and adjusted the related probable insurance recovery up to $2.0 billion, we would have recorded an additional pretax charge of $879 million ($753 million after-tax).

Using Dr. Rabinovitz's projections, we then conducted an analysis to determine the amount of insurance that we estimate is probable that we will recover in relation to the projected claims and defense costs through 2052. In conducting this analysis, we:

- reviewed DII Industries, LLC's historical course of dealings with its insurance companies concerning the payment of asbestos-related claims, including DII Industries, LLC's 15 year litigation and settlement history;

- reviewed the terms of DII Industries, LLC's prior and current coverage-in-place settlement agreements;
- reviewed the status of DII Industries, LLC's and Kellogg, Brown & Root, Inc.'s current insurance-related lawsuits and the various legal positions of the parties in those lawsuits in relation to the developed and developing case law and the historic positions taken by insurers in the earlier filed and settled lawsuits;
- engaged in discussions with our counsel; and

- analyzed publicly-available information concerning the ability of the DII Industries, LLC's insurers to meet their obligations.

Based on that review, analyses and discussions, we made judgements concerning insurance coverage that we believe are reasonable and consistent with our historical course of dealings with our insurers and the relevant case law to determine the probable insurance recoveries for DII Industries, LLC's asbestos liabilities through 2052. This analysis factored in the probable effects of self-insurance features, such as self-insured retentions, policy exclusions, liability caps, current and anticipated insolvencies of DII Industries, LLC's insurers, and various judicial determinations relevant to DII Industries, LLC's insurance programs.

Based on Dr. Rabinovitz's projections and our analysis of the probable insurance recoveries, we established reserves for the probable and reasonably estimable liabilities and defense costs we believe we will pay through 2052 of $2.2 billion, and we have also recorded receivables for the insurance recoveries that are deemed probable through that same date of $1.6 billion. These reserves and insurance receivables are included in noncurrent assets and liabilities due to the extended time periods involved to settle claims. In the second quarter of 2002, we recorded a pretax charge of $483 million. Of this pretax charge, $330 million, $268 million after-tax, was recorded for claims related to Brown & Root construction and renovation projects and was recorded under the Engineering and Construction Group segment. The balance of $153 million, $123 million after-tax, related to claims associated with businesses no longer owned by us and was recorded as discontinued operations. The low effective tax rate on the asbestos charge is due to the recording of a valuation allowance against the United States federal deferred tax asset associated with the accrual as the deferred tax asset may not be fully realizable based upon future taxable income projections.

The total estimated claims through 2052, including the 312,000 current open claims, are approximately one million. A summary of our reserves for these claims and corresponding insurance recoveries is as follows:

Millions of dollars	June 30 2002	December 31 2001
Asbestos litigation claims	$ 2,196	$ 737
Estimated insurance recoveries:		
Highlands Insurance Company	-	(45)
Other insurance carriers	(1,594)	(567)
Insurance for asbestos litigation claims	(1,594)	(612)
Net liability for open and future (through 2052) asbestos claims	$ 602	$ 125

Accounts receivable for billings to insurance companies for payments made on asbestos claims were $30 million at June 30, 2002, and $18 million at December 31, 2001, excluding accounts receivable written off at the conclusion of the Highlands litigation.

The insurance recoveries we have recorded do not assume any recovery from insolvent insurers or from any state insurance guaranty association and assume that all but one of our insurance companies that are currently solvent will continue to be solvent throughout the period of the applicable recoveries in the projections. However, there can be no assurances that these assumptions will be correct. The insurance receivables do not exhaust the applicable insurance coverage for asbestos-related liabilities.

Given the inherent uncertainty in making future projections, we plan to have the projections periodically reexamined, and update them based on our experience and other relevant factors such as changes in the tort system and the resolution of the bankruptcies of various asbestos defendants. Similarly, we will re-evaluate our projections concerning our probable insurance recoveries in light of any updates to Dr. Rabinovitz's projections, developments in DII Industries, LLC's and Kellogg, Brown & Root, Inc.'s various lawsuits against its insurance companies and other developments that may impact the probable insurance recoveries.

Securities and Exchange Commission ("SEC") Preliminary Inquiry and Fortune 500 Review. In late May 2002, we received a letter from the Fort Worth District Office of the Securities and Exchange Commission stating that it was initiating a preliminary inquiry into certain of our accounting practices. On June 11, 2002, we received an additional letter requesting information regarding our accounting for cost overruns on construction projects and requesting our voluntary assistance. We responded to that request promptly and met with members of the SEC staff to discuss our response. We received a further request for voluntary assistance on July 11, 2002, which requested additional explanations and supporting documentation. We are in the process of collecting the requested documents and preparing responses to specific inquiries. We are fully cooperating and actively engaged in assisting in the SEC's review.

The SEC's preliminary inquiry largely relates to our accruals of revenue from unapproved claims on engineering and construction contracts and whether we timely disclosed our accrual practice. Accrual of revenue from unapproved claims is an accepted and widely followed accounting practice for companies in the engineering and construction business. Although we accrued unapproved claims in 1998, we first disclosed the accruals in our 1999 Annual Report on Form 10-K. We believe we properly applied the required methodology of the American Institute of Certified Public Accountants' Statement of Position 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts", and satisfied the relevant criteria for accruing this revenue. The SEC may conclude otherwise.

On December 21, 2001, the SEC's Division of Corporation Finance announced that it would review the annual reports of all Fortune 500 companies that file periodic reports with the SEC. Accordingly, our 2001 Annual Report on Form 10-K is subject to special review by the SEC staff and we may receive comments from the SEC staff in addition to the matters described above. If so, we will promptly respond and attempt to resolve any questions raised by the Division of Corporation Finance.

Securities litigation. On June 3, 2002, a class action lawsuit was filed against us in the United States District Court for the Northern District of Texas on behalf of purchasers of our common stock alleging violations of the federal securities laws. After that date, in excess of fifteen similar class actions were filed against us in that or other federal District Courts. Several of those lawsuits also named as defendants Arthur Andersen, LLP ("Arthur Andersen"), our independent accountants for the period covered by the lawsuit, and several of our present or former officers and directors. Those lawsuits allege that we violated federal securities laws in failing to disclose a change in the manner in which we accounted for unapproved claims on engineering and construction contracts, and that we overstated revenue by accruing the unapproved claims. One such action has since been dismissed voluntarily, without prejudice, upon motion by the filing plaintiff.

In addition to those class actions, two additional class actions have been filed against us and several of our present or former officers and directors alleging different causes of action based upon essentially the same facts and circumstances alleged in the federal securities fraud class actions. One such action, filed in the United States District Court for the Northern District of Texas, alleges violations of ERISA based on the purchase of our securities for our 401(k) retirement plan when we allegedly knew, or should have known, that our financial statements understated losses on certain construction contracts because of our accrual of revenues for as yet unresolved contract claims. The other, which joins Arthur Andersen as an additional defendant, alleges violations of Texas statutory and common law based on the same facts and circumstances as the other cases.

The damages in all of these cases are unspecified. We believe that our actions in accruing revenue for unresolved construction contract claims and related disclosures were appropriate, and that the various class actions described above should be resolved in our favor. Therefore, we intend to deny any wrongdoing and to vigorously defend against these lawsuits. However, at this point all of these lawsuits are in a very preliminary stage, we have not been called upon to file responsive pleadings or dispositive motions, and discovery has not commenced. Although we believe that our position ultimately will be vindicated, it is not possible to estimate the amount of loss or range of possible loss that might result from adverse judgments or settlements of these matters.

BJ Services Company patent litigation. On April 12, 2002, a federal court jury in Houston, Texas, returned a verdict against Halliburton Energy Services, Inc. in the patent infringement lawsuit brought by BJ Services Company, or BJ. The lawsuit alleged that a well fracturing fluid system used by Halliburton Energy Services infringed a patent issued to BJ in January 2000 for a method of well fracturing using a specific fracturing fluid. The jury awarded BJ approximately $98 million in damages, plus pre-judgment interest, less than one-quarter of BJ's claim at the beginning of the trial. The jury also found that there was no intentional infringement by Halliburton Energy Services. As a result of the jury's determination of infringement, the court has enjoined us from further use of our Phoenix fracturing fluid. We have posted a supersedeas bond in the amount of approximately $106 million to cover the damage award, pre-judgment and post-judgment interest, and awardable costs. We have timely appealed this verdict to the Court of Appeals for the Federal Circuit, which hears all appeals of patent cases. We believe that BJ's patent is invalid and unenforceable on a number of grounds, and intend to pursue vigorously our appeal. We have alternative products to use in our fracturing operations, and do not expect the loss of the use of the Phoenix fracturing fluid to have a material adverse impact on our overall energy services business.

Improper payments reported to the Securities and Exchange Commission. We have reported to the Securities and Exchange Commission that one of our foreign subsidiaries operating in Nigeria made improper payments of approximately $2.4 million to a Nigerian national who held himself out as a tax consultant when in fact he was an employee of a local tax authority. The payments were made to obtain favorable tax treatment and clearly violated our Code of Business Conduct and our internal control procedures. The payments were

discovered during an audit of the foreign subsidiary. We have conducted an investigation assisted by outside legal counsel. Based on the findings of the investigation we have terminated several employees. None of our senior officers were involved. We are cooperating with the Securities and Exchange Commission in its review of the matter. We plan to take further action to ensure that our foreign subsidiary pays all taxes owed in Nigeria, which may be as much as an additional $3 million and this amount was fully accrued as of March 31, 2002. The integrity of our Code of Business Conduct and our internal control procedures are essential to the way we conduct business.

Environmental. We are subject to numerous environmental legal and regulatory requirements related to our operations worldwide. We take a proactive approach to evaluating and addressing the environmental impact of our operations. Each year we assess and remediate contaminated properties in order to avoid future liabilities and comply with legal and regulatory requirements. On occasion we are involved in specific environmental litigation and claims, including the clean-up of properties we own or have operated as well as efforts to meet or correct compliance-related matters.

We also incur costs related to compliance with ever-changing environmental, legal and regulatory requirements in the jurisdictions where we operate. It is very difficult to quantify the potential liabilities. We do not expect these expenditures to have a material adverse effect on our consolidated financial position or our results of operations. Our accrued liabilities for environmental matters were $48 million as of June 30, 2002 and $49 million as of December 31, 2001.

Letters of credit. In the normal course of business, we have agreements with banks under which approximately $1.3 billion of letters of credit or bank guarantees were issued, including $220 million which relate to our joint ventures' operations. Of these financial instruments, $260 million include provisions that allow the banks to require cash collateralization if our debt ratings fall below the investment grade ratings of BBB- by Standard & Poor's or Baa3 by Moody's Investors' Services. If our debt ratings fall below investment grade, we would also be in technical breach of a bank agreement covering another $127 million of letters of credit at June 30, 2002, which might entitle the bank to set-off rights. In addition, a $151 million letter of credit line, of which $85 million has been issued, includes provisions that allow the bank to require cash collateralization for the full line if debt ratings of either rating agency fall below the rating of BBB by Standard & Poor's or Baa2 by Moody's Investors' Services. These letters of credit and bank guarantees generally relate to our guaranteed performance or retention payments under our long-term contracts and self-insurance. In the past, no significant claims have been made against these financial instruments. We do not anticipate material losses to occur as a result of these financial instruments.

Liquidated damages. We have not accrued $280 million at June 30, 2002 and $97 million at December 31, 2001 of contractual obligations for schedule-related liquidated damages as we do not believe payment is probable. We believe we have valid claims for schedule extensions against the customers which would counter these liquidated damages. Of the total liquidated damages, $260 million at June 30, 2002 and $77 million at December 31, 2001 relate to unasserted liquidated damages for one project in Brazil. The estimated schedule impact of change orders requested by the customer is expected to cover approximately one-half of the $260 million exposure at June 30, 2002 and claims for schedule extension are expected to cover the remaining exposure.

Other. We are a party to various other legal proceedings. We expense the cost of legal fees related to these proceedings. We believe any liabilities we may have arising from these proceedings will not be material to our consolidated financial position or results of operations.

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Note 9. Income (loss) Per Share

Millions of dollars and shares except per share data	Three Months Ended June 30 2002	Three Months Ended June 30 2001	Six Ende[d] 2002
Income (loss) from continuing operations before change in accounting method, net	$ (358)	$ 143	$ (308)
Basic weighted average shares	432	427	432
Effect of common stock equivalents	-	3	-
Diluted weighted average shares	432	430	432

Income (loss) per common share from continuing operations before change in accounting method, net:			
Basic	$ (0.83)	$ 0.34	$ (0.71)
Diluted	$ (0.83)	$ 0.33	$ (0.71)

Basic income (loss) per share is based on the weighted average number of common shares outstanding during the period. Diluted income (loss) per share includes additional common shares that would have been outstanding if potential common shares with a dilutive effect had been issued. For the second quarter 2002 and the six months ended June 30, 2002, we have used the basic weighted average shares in the calculation as the effect of the common stock equivalents would be anti-dilutive based upon the net loss from continuing operations. Included in the computation of diluted income per share at June 30, 2001 are rights we issued in connection with the PES acquisition for 0.7 million shares of Halliburton common stock. Excluded from the computation of diluted income per share are options to purchase 1.9 million shares of common stock which were outstanding during the three months ended June 30, 2001 and options to purchase 2.1 million shares of common stock which were outstanding during the six months ended June 30, 2001. These options were outstanding during the applicable period, but were excluded because the option exercise price was greater than the average market price of the common shares.

Note 10. Comprehensive Income (loss)

The components of other comprehensive income adjustments to net income (loss) include the cumulative translation adjustment of some of our foreign entities, minimum pension liability adjustments and unrealized gains on investments and derivatives.

	Three Months Ended June 30		Six Ende
Millions of dollars	2002	2001	2002
Net income (loss)	$ (498)	$ 382	$ (476)
Cumulative translation adjustment, net of tax	32	(4)	35
Less reclassification adjustment for gains included in net income	-	102	-
Net cumulative translation adjustment, net of tax	32	98	35
Adjustment to minimum pension liability	-	12	-
Unrealized gains on investments and derivatives	-	4	-
Total comprehensive income (loss)	$ (466)	$ 496	$ (441)

Accumulated other comprehensive income at June 30, 2002 and December 31, 2001 consisted of the following:

	June 30	December 31
Millions of dollars	2002	2001
Cumulative translation adjustment	$ (170)	$ (205)
Pension liability adjustments	(27)	(27)
Unrealized losses on investments and derivatives	(4)	(4)

Total accumulated other comprehensive income	$ (201)	$ (236)

Note 11. Goodwill and Other Intangible Assets

Effective January 1, 2002, we adopted the Financial Accounting Standards Board SFAS No. 142 "Goodwill and Other Intangible Assets", and in accordance with the statement, amortization of goodwill has been discontinued. We have reviewed this new statement and determined that our reporting units as defined under SFAS No. 142 will be the same as our reportable operating segments: Energy Services Group and Engineering and Construction Group. We have completed the impairment tests of goodwill as of January 1, 2002 and determined that our goodwill for each reporting unit is not impaired. We also reevaluated our intangible assets and determined that their remaining useful life is appropriate.

Had we been accounting for our goodwill under SFAS No. 142 for all periods presented, our net income (loss) and earnings (loss) per share would have been as follows.

	Three Months Ended June 30		Six Months Ended June 30	
Millions of dollars	2002	2001	2002	2001
Reported net income (loss)	$ (498)	$ 382	$ (476)	$ 491
Goodwill amortization, net of tax	-	10	-	19
Adjusted net income (loss)	$ (498)	$ 392	$ (476)	$ 510
Basic earnings (loss) per share:				
Reported net income (loss)	$ (1.15)	$ 0.90	$ (1.10)	$ 1.15
Goodwill amortization, net of tax	-	0.02	-	0.04
Adjusted net income (loss)	$ (1.15)	$ 0.92	$ (1.10)	$ 1.19
Diluted earnings (loss) per share:				
Reported net income (loss)	$ (1.15)	$ 0.89	$ (1.10)	$ 1.14
Goodwill amortization, net of tax	-	0.02	-	0.04
Adjusted net income (loss)	$ (1.15)	$ 0.91	$ (1.10)	$ 1.18

Note 12. Accounts Receivable Securitization

On April 15, 2002, we entered into an agreement to sell accounts receivable to a bankruptcy-remote limited-purpose funding subsidiary. Under the terms of the agreement, new receivables are added on a continuous basis to the pool of receivables, and collections reduce previously sold accounts receivable. This funding subsidiary sells an undivided ownership interest in this pool of receivables to entities managed by unaffiliated financial institutions under another agreement. Sales to the funding subsidiary have been structured as "true sales" under applicable bankruptcy laws, and the assets of the funding subsidiary are not available to pay any creditors of Halliburton or of its subsidiaries or affiliates, until such time as the agreement with the unaffiliated companies is terminated following sufficient collections to liquidate all outstanding undivided ownership interests. The funding subsidiary retains the interest in the pool of receivables that are not sold to the unaffiliated companies, and is fully consolidated and reported in our financial statements.

The amount of undivided interests, which can be sold under the program, varies based on the amount of eligible receivables in the pool at any given time and other factors. As of June 30, 2002, the funding subsidiary sold a $200 million undivided ownership interest to the unaffiliated companies, and may from time to time sell additional undivided ownership interests. We continue to service, administer and collect the receivables on behalf of the purchaser. The amount of undivided ownership interest in the pool of receivables sold to the unaffiliated companies is reflected as a reduction of accounts receivable in our consolidated balance sheet and as an increase in cash flows from operating activities in our consolidated statement of cash flows.

Note 13. Reorganization of Business Operations

On March 18, 2002 we announced plans to restructure our businesses into two wholly owned operating subsidiary groups, the Energy Services Group and the Engineering and Construction Group. As part of this reorganization, we are

separating and consolidating the entities in our Energy Services Group together as direct and indirect subsidiaries of Halliburton Energy Services, Inc. We are also separating and consolidating the entities in our Engineering and Construction Group together as direct and indirect subsidiaries of the former Dresser Industries Inc., which became a limited liability company during the quarter and was renamed DII Industries, LLC. The reorganization of business operations will facilitate the separation, organizationally, financially, and operationally, of our two business segments, which we believe will significantly improve operating efficiencies in both, while streamlining management and easing manpower requirements. In addition, many support functions which were previously shared were moved into the two business groups. As a result, we took actions in the first and second quarter of 2002 to reduce our cost structure by reducing personnel, moving previously shared support functions into the two business groups and realigning ownership of international subsidiaries by group. In the 2002 second quarter, we incurred approximately $56 million, for a total of $67 million for the year, of personnel reduction costs and asset related write-offs. Of this amount, $15 million remains in accruals for severance arrangements. We expect these remaining payments will be made during the second half of 2002. Reorganization charges for the year consisted of $44 million in personnel related expense, $13 million of asset related write-downs, $7 million in professional fees related to the restructuring, and $3 million related to contract terminations. Although we have no specific plans currently, the reorganization would facilitate separation of the ownership of the two businesses in the future if we identify an opportunity that produces greater value for our shareholders than continuing to own both businesses.

Note 14. Impairment of Equity Investment

On July 22, 2002, we signed a letter of intent to sell our 50% interest in the Bredero-Shaw joint venture to our partner, ShawCor Ltd. (SCL.A/TSE). The purchase price of $150 million will be paid $50 million in cash and $100 million in stock and notes. The transaction is subject to approval by each of our Boards of Directors, execution of definitive agreements, and regulatory approvals. During the second quarter of 2002 we recorded a pretax charge of $61 million, or $0.14 per diluted share after-tax in our Energy Services Group, to reflect the impairment of our investment in Bredero-Shaw as a result of the pending transaction.

Note 15. Long-Term Debt and Financial Instruments

On June 26, 2002 we terminated our interest rate swap agreement on our 8% senior note. The notional amount of the swap agreement was $139 million. This interest rate swap was designated as a fair value hedge under SFAS No. 133. Upon termination, the fair value of the interest rate swap was $0.5 million, and had previously been classified in Other assets on the balance sheet. The fair value adjustment to the debt instrument that was hedged will remain and be amortized as a reduction in interest expense using the "Effective Yield Method" over the remaining life of the note.

Note 16. DII Industries, LLC Financial Information

Dresser Industries, Inc. was converted into a Delaware limited liability company during the second quarter of 2002 and its name was changed to DII Industries, LLC. Since becoming a wholly owned subsidiary, DII Industries, LLC has ceased filing periodic reports with the Securities and Exchange Commission. DII Industries, LLC's 8% guaranteed senior notes, which were initially issued by Baroid Corporation, remain outstanding and are fully and unconditionally guaranteed by Halliburton. In January 1999, as part of a legal reorganization associated with the merger, Halliburton Delaware, Inc., our first tier holding company subsidiary, was merged into DII Industries, LLC. The majority of our operating assets and activities are now included in DII Industries, LLC and its subsidiaries. In August 2000, the Securities and Exchange Commission released revised rules governing the financial statements of guarantors and issuers of guaranteed registered securities. The following condensed consolidating financial information presents Halliburton and our subsidiaries on a stand-alone basis using the equity method of accounting for our interest in our subsidiaries.

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Condensed Consolidating Statements of Income
Quarter ended June 30, 2002

Millions of dollars	Non-issuer/ Non-guarantor Subsidiaries	DII Industries, LLC (Issuer)	Halliburton Company (Guarantor)	Consolid Adjustm
Total revenues	$ 3,235	$(483)	$ (487)	$
Cost of revenues	(3,543)	-	-	
General and administrative	(97)	-	-	
Interest expense	(10)	(8)	(12)	
Interest income	11	4	15	
Other, net	(4)	(3)	-	
Income from continuing operations before taxes and minority interest	(408)	(490)	(484)	
Provision for income taxes	70	3	4	
Minority interest in net income of subsidiaries	(5)	-	-	
Income from continuing operations	(343)	(487)	(480)	
Income from discontinued operations	(140)	-	-	
Net income	$ (483)	$(487)	$ (480)	$

Condensed Consolidating Statements of Income
Quarter ended June 30, 2001

Millions of dollars	Non-issuer/ Non-guarantor Subsidiaries	DII Industries, LLC (Issuer)	Halliburton Company (Guarantor)	Consolid Adjustm
Total revenues	$ 3,339	$ 170	$ 525	$ (
Cost of revenues	(2,966)	-	-	
General and administrative	(101)	-	-	
Interest expense	(16)	(8)	(10)	
Interest income	5	3	29	
Other, net	10	125	(17)	(
Income from continuing operations before taxes and minority interest	271	290	527	(
Provision for income taxes	(99)	(4)	5	
Minority interest in net income of subsidiaries	(2)	-	-	
Income from continuing operations	170	286	532	(
Income from discontinued operations	-	239	-	
Net income	$ 170	$ 525	$ 532	$ (

Condensed Consolidating Statements of Income
Six Months ended June 30, 2002

Millions of dollars	Non-issuer/ Non-guarantor Subsidiaries	DII Industries, LLC (Issuer)	Halliburton Company (Guarantor)	Consolid Adjustm
Total revenues	$ 6,242	$ (447)	$ (457)	$
Cost of revenues	(6,374)	-	-	
General and administrative	(150)	-	-	
Interest expense	(22)	(16)	(24)	
Interest income	15	4	28	
Other, net	(8)	(3)	-	
Income from continuing operations before taxes, minority interest and accounting change	(297)	(462)	(453)	
Provision for income taxes	28	5	8	
Minority interest in net income of subsidiaries	(10)	-	-	
Income from continuing operations before accounting change	(279)	(457)	(445)	

Income from discontinued operations	(168)	-	-	
Cumulative effect of accounting change, net	-	-	-	
Net income	$ (447)	$ (457)	$ (445)	$

Condensed Consolidating Statements of Income
Six Months ended June 30, 2001

Millions of dollars	Non-issuer/ Non-guarantor Subsidiaries	DII Industries, LLC (Issuer)	Halliburton Company (Guarantor)	Consolid Adjustm
Total revenues	$ 6,483	$ 306	$ 673	$
Cost of revenues	(5,821)	-	-	
General and administrative	(192)	-	-	
Interest expense	(21)	(17)	(44)	
Interest income	9	6	29	
Other, net	(1)	146	(4)	
Income from continuing operations before taxes and minority interest	457	441	654	
Provision for income taxes	(167)	(7)	15	
Minority interest in net income of subsidiaries	(7)	-	-	
Income from continuing operations before accounting change	283	434	669	
Income from discontinued operations	22	239	-	
Cumulative effect of accounting change, net	1	-	-	
Net income	$ 306	$ 673	$ 669	$

Condensed Consolidating Balance Sheets
June 30, 2002

Millions of dollars	Non-issuer/ Non-guarantor Subsidiaries	DII Industries, LLC (Issuer)	Halliburton Company (Guarantor)	Consolid Adjustm