Reports of Management and Independent Accountants

PLAINTIFF'S EXHIBIT

HW-552

Report of Management

The consolidated financial statements of Dresser Industries, Inc. have been prepared by management and have been examined by independent accountants. The management of the Company is responsible for the financial information and representations contained in the financial statements and other sections of the annual report. Management believes that the financial statements have been prepared in conformity with generally accepted accounting principles appropriate under the circumstances to reflect, in all material respects, the substance of events and transactions that should be included. In preparing the financial statements, it is necessary that management make informed estimates and judgments based on currently available information of the effects of certain events and transactions.

In meeting its responsibility for the reliability of the financial statements, management depends on the Company's system of internal accounting control. This system is designed to provide reasonable assurance that assets are safeguarded and transactions are executed in accordance with management's authorization and properly recorded. In designing control procedures, management recognizes that errors or irregularities may nevertheless occur. Also, estimates and judgments are required to assess and balance the relative cost and expected benefits of the controls. Management believes that the Company's accounting controls provide reasonable assurance that errors or irregularities that could be material to the financial statements are prevented or would be detected within a timely period by employees in the normal course of performing their assigned functions.

The Board of Directors pursues its oversight role for the accompanying financial statements through its Audit and Finance Committee, which is composed solely of directors who are not officers or employees of the Company. The Committee meets with management and the internal auditors to review the work of each and to monitor the discharge by each of its responsibilities. The Committee also meets with the independent accountants, without management present, to discuss internal control structure, auditing and financial reporting matters.

Report of Independent Accountants

Price Waterhouse

To the Shareholders and Board of Directors of Dresser Industries, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of earnings, of shareholders' investment and of cash flows present fairly, in all material respects, the financial position of Dresser Industries, Inc. and its subsidiaries at October 31, 1988, 1987, and 1986, and the results of their operations and their cash flows for the years then ended in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

Price Waterhouse

Price Waterhouse

Dallas, Texas
December 19, 1988

Consolidated Statements of Earnings

Dresser Industries, Inc. and Subsidiaries

In Millions of Dollars Except Per Share Data — Years Ended October 31,	1988	1987	1986
Sales revenues	$3,226.7	$3,030.9	$3,431.8
Service revenues — Notes C and D	715.0	88.8	229.5
Total sales and service revenues	3,941.7	3,119.7	3,661.3
Cost of sales	2,253.0	2,154.4	2,483.9
Cost of services	651.0	88.4	230.5
Total costs of sales and services — Notes D, F and N	2,904.0	2,242.8	2,714.4
Gross earnings	1,037.7	876.9	946.9
Selling, engineering, administrative and general expenses — Note N	886.4	852.6	970.4
Special charges — Note N	—	—	25.3
Earnings (loss) from operations	151.3	24.3	(48.8)
Other income (deductions)			
Interest expense	(46.6)	(97.1)	(75.1)
Interest earned	41.5	35.6	37.0
Royalties earned	19.4	9.7	12.5
Pension plan settlements — Note M	13.6	88.9	61.7
Partnership operations — Note B	1.0	(36.8)	—
Other, net — Note N	(1.6)	14.7	35.5
Total other income	27.3	15.0	71.6
Earnings from continuing operations before income taxes, minority interest and equity earnings	178.6	39.3	22.8
Income taxes — Note G	(64.1)	(48.0)	(52.5)
Minority interest in (earnings) losses of subsidiaries — Note C	(6.3)	15.2	(3.2)
Equity in earnings of unconsolidated subsidiaries and affiliates — Note B	14.6	9.8	7.8
Earnings (loss) from continuing operations	122.8	16.3	(25.1)
Discontinued operations — Note B	22.7	26.7	25.6
Earnings before extraordinary item	145.5	43.0	.5
Extraordinary item — tax benefits from loss carryforwards — Notes B and G	11.3	5.9	9.1
Net earnings	$ 156.8	$ 48.9	$ 9.6
Earnings per common share — Note N			
Earnings (loss) from continuing operations	$ 1.78	$ .22	$ (.32)
Discontinued operations	.33	.35	.33
Earnings before extraordinary item	2.11	.57	.01
Extraordinary tax benefits	.16	.08	.11
Net earnings	$ 2.27	$ .65	$ .12

See Accompanying Notes to Consolidated Financial Statements.

Consolidated Balance Sheets

Dresser Industries, Inc. and Subsidiaries

Assets

In Millions of Dollars — October 31	1988	1987	1986
Current Assets			
Cash	$ 87.9	$ 81.9	$ 45.3
Short-term investments — at cost (approximates market)	100.0	211.5	291.0
Notes and accounts receivable — public — Note D	661.1	721.6	756.6
Notes and accounts receivable from unconsolidated subsidiaries and affiliates	254.2	100.7	63.8
Less allowance for doubtful receivables	37.0	46.3	71.5
	878.3	776.0	748.9
Inventories — Note E			
Finished products and work in process	385.5	483.7	513.1
Raw materials and supplies	82.4	129.3	153.0
	467.9	613.0	666.1
Investment in discontinued operations — Note B	—	173.3	
Refundable and deferred income taxes — Note G	98.2	103.2	59.8
Prepaid expenses	14.9	12.7	17.3
Total Current Assets	1,647.2	1,971.6	1,828.4
Investments and Other Assets			
Investments in unconsolidated subsidiaries and affiliates — Note B	504.8	396.8	517.5
Intangibles — Notes C and F	251.4	.5	9.4
Long-term receivables and investments	12.3	7.2	7.5
Other assets and deferred income taxes — Notes G and M	26.2	32.6	59.0
Total Investments and Other Assets	794.7	437.1	593.4
Property, Plant and Equipment — at cost			
Land, land improvements and mineral deposits	68.0	61.4	69.8
Buildings	279.7	304.0	353.8
Machinery and equipment	992.2	1,000.5	1,281.1
	1,339.9	1,365.9	1,704.7
Less accumulated depreciation, depletion and amortization — Note N	882.4	892.3	1,016.3
Total Properties — Net	457.5	473.6	688.4
	$2,899.4	$2,882.3	$3,110.2

See Accompanying Notes to Consolidated Financial Statements.

Liabilities and Shareholders' Investment

In Millions of Dollars — October 31,	1988	1987	1986
Current Liabilities			
Short-term debt — Note H	$ 26.9	$ 61.3	$ 171.0
Accounts payable — public	201.9	244.8	226.3
Accounts payable to unconsolidated subsidiaries and affiliates	52.6	22.0	4.9
Accrued compensation and benefits — Note M	165.1	146.4	151.6
Accrued warranty costs	40.2	44.7	56.1
Accrued taxes other than income taxes	25.3	38.0	41.9
Advances from customers on contracts — Note D	142.8	15.5	28.3
Accrued interest	25.2	50.2	15.7
Other accrued liabilities	167.3	158.1	190.5
Income taxes — Note G	69.6	55.0	31.2
Current portion of long-term debt — Note I	10.6	14.3	23.6
Total Current Liabilities	927.5	850.3	941.1
Long-Term Debt — Note I	255.2	271.1	358.7
Pension Plans — Note M	65.3	70.2	113.1
Deferred Compensation and Other Liabilities — Notes F and J	69.0	69.6	63.6
Minority Interest — Note C	77.7	71.1	20.1
Shareholders' Investment — Notes I, J, K and N			
Common shares, $0.25 par value			
Authorized shares: 200,000,000			
Issued shares: 83,024,224 in 1988, 82,955,149 in 1987 and 82,808,969 in 1986	20.7	20.7	20.7
Capital in excess of par value	438.3	436.2	432.6
Cumulative translation adjustments	(24.4)	(4.3)	(34.8)
Retained earnings	1,475.4	1,356.7	1,338.1
	1,910.0	1,809.3	1,756.6
Less treasury shares, at cost	405.3	259.3	143.0
Total Shareholders' Investment	1,504.7	1,550.0	1,613.6
Commitments and Contingencies — Notes L and M			
	$2,899.4	$2,882.3	$3,110.2

See Accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Shareholders' Investment

Dresser Industries, Inc. and Subsidiaries

In Millions of Dollars — Years Ended October 31,	1988	1987	1986
Common Shares, Par Value — Notes J and K			
Beginning of year	$ 20.7	$ 20.7	$ 20.6
Shares issued in connection with employee benefit and dividend reinvestment plans	—	—	.1
End of year	$ 20.7	$ 20.7	$ 20.7
Capital in Excess of Par Value			
Beginning of year	$ 436.2	$ 432.6	$ 422.6
Shares issued in connection with employee benefit and dividend reinvestment plans	2.1	3.6	10.0
End of year	$ 438.3	$ 436.2	$ 432.6
Cumulative Translation Adjustments			
Beginning of year	$ (4.3)	$ (34.8)	$ (57.8)
Adjustments due to translation rate changes during the year	(20.1)	30.5	23.0
End of year	$ (24.4)	$ (4.3)	$ (34.8)
Retained Earnings — Note I			
Beginning of year	$1,356.7	$1,338.1	$1,382.8
Net earnings	156.8	48.9	9.6
Dividends on common shares at $.55 a share in 1988, $.40 a share in 1987 and $.70 a share in 1986	(38.1)	(30.3)	(54.3)
End of year	$1,475.4	$1,356.7	$1,338.1
Treasury Shares, at Cost — Notes J and K			
Beginning of year	$ (259.3)	$ (143.0)	$ (122.0)
Shares acquired	(153.3)	(123.3)	(21.0)
Shares issued in connection with employee benefit and dividend reinvestment plans	7.3	7.0	—
End of year	$ (405.3)	$ (259.3)	$ (143.0)
Total Shareholders' Investment, End of Year	$1,504.7	$1,550.0	$1,613.6

See Accompanying Notes to Consolidated Financial Statements

Consolidated Statements of Cash Flows

Dresser Industries, Inc. and Subsidiaries

In Millions of Dollars — Years Ended October 31	1988	1987	1986
Cash flows from operating activities:			
Net earnings	$ 156.8	$ 48.9	$ 9.6
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation, depletion and amortization	96.9	120.4	162.0
Special charges	—	—	25.3
Gain on business disposals	(42.9)	(5.6)	—
Equity in earnings of unconsolidated subsidiaries and affiliates	(14.6)	(9.8)	(7.8)
Equity in partnership (earnings) losses	(1.0)	36.8	—
Minority interest in losses (earnings)	6.3	(15.2)	3.2
Settlement of Hughes litigation	(23.0)	—	—
Decrease (increase) in receivables	(47.1)	(73.2)	195.7
Decrease (increase) in inventories	(53.7)	(17.3)	66.9
Decrease (increase) in refundable and deferred income taxes and prepaid expenses	1.8	(40.1)	46.0
Increase (decrease) in accounts payable and accrued liabilities	28.6	63.3	(109.7)
(Decrease) in advances from customers on contracts	(51.9)	(12.8)	(16.7)
Increase (decrease) in income taxes payable	(19.6)	28.7	11.6
Increase (decrease) in pension liability	(20.6)	(42.9)	55.6
Other — net	(23.7)	6.0	(26.7)
Total adjustments	(164.5)	38.3	405.4
Net cash provided by (used in) operating activities	(7.7)	87.2	415.0
Cash flows from investing activities:			
Business acquisitions	(114.1)	—	(30.6)
Cash and cash equivalents of acquired company	75.9	—	—
Cash and cash equivalents transferred to joint venture companies	(5.3)	(23.3)	—
Capital expenditures	(62.5)	(57.4)	(71.1)
Cash received from (paid to) unconsolidated subsidiaries and affiliates	(38.6)	210.0	(107.1)
Proceeds from sales of assets	4.7	47.6	41.2
Business disposals	274.4	37.8	—
Net cash provided by (used in) investing activities	134.5	214.7	(167.6)
Cash flows from financing activities:			
Increase in (reduction of) long-term debt	(14.0)	(85.7)	(44.5)
Increase in (reduction of) short-term debt and current portion of long-term debt	(38.0)	(124.6)	27.7
Proceeds from sale of common shares	2.1	3.6	10.1
Dividends paid	(38.1)	(30.3)	(54.3)
Purchases of common shares for treasury	(146.0)	(116.3)	(21.0)
Net cash (used in) financing activities	(234.0)	(353.3)	(82.0)
Effect of translation adjustments on cash	1.7	8.5	6.7
Net increase (decrease) in cash and cash equivalents	(105.5)	(42.9)	172.1
Cash and cash equivalents, beginning of year	293.4	336.3	164.2
Cash and cash equivalents, end of year	$ 187.9	$ 293.4	$ 336.3

Supplemental information concerning non-cash investing and financing activities is included in Notes B and C. Income taxes paid and interest paid are disclosed in Notes G and I, respectively.

See Accompanying Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

Note A — Summary of Significant Accounting Policies

Consolidation

All majority-owned domestic subsidiaries are consolidated except for wholly-owned financial service, insurance, real estate and equipment distribution companies. All majority-owned foreign subsidiaries are consolidated. All material intercompany accounts and transactions are eliminated.

Investments in unconsolidated subsidiaries and in 20-50% owned partnerships and affiliates are reported at cost adjusted for the Company's equity in undistributed earnings or losses. Earnings which are subject to material financial or political risks are not recognized until remitted.

Receivables

Appropriate allowances are provided for all doubtful receivables, and an allowance is provided for all receivables delinquent for more than 180 days unless an account does not represent a collection risk.

Long-Term Contracts

Revenues and earnings from long-term engineering and construction contracts are recognized on the percentage-of-completion method, measured generally on a cost incurred basis. Estimated contract costs include allowances for completion risks, process and schedule guarantees and warranties that generally are not finally determinable until the latter stages of a contract. Estimated contract earnings are reviewed and revised periodically as the work progresses, and the cumulative effect of any change is recognized in the period determined. Estimated losses are charged against earnings in the period such losses are estimated. Amounts billed in excess of revenues recognized to date are included in current liabilities under advances from customers on contracts.

Inventories

Inventories are valued at the lower of cost or market. The cost of most U.S. inventories is determined using the last-in, first-out (LIFO) method. Inventories not on LIFO, principally inventories not included in the Company's U.S. Federal income tax return, are determined using average cost. Obsolete items or excess quantities which are determined to be unsalable are valued at their net realizable value.

Property, Plant and Equipment

Fixed assets are depreciated over the estimated service life. Accelerated depreciation methods are used for financial statement purposes, except for U.S. fixed assets with a service life of ten years or less, which are depreciated on a straight-line basis. Accelerated depreciation methods are also used for tax purposes, wherever permitted. All significant fixed assets are reviewed periodically and, if determined to be excess, obsolete, or unsuitable for their intended use, are reduced to values recognizing their impaired utility or are assigned shorter remaining useful lives for depreciation purposes. Due to the large number of asset classes, it is not practicable to state the rates used in computing the provisions for depreciation. Depletion of mineral properties is based upon estimates of economically recoverable tonnage. Maintenance and repairs are expensed as incurred. Betterments are capitalized.

Intangibles

The difference between purchase price and fair values at date of acquisition of net assets of businesses acquired after October 31, 1970 is amortized on a straight-line basis over the estimated period benefited, not exceeding 40 years. The costs of patents acquired in connection with business acquisitions are amortized on a straight-line basis over the remaining economic life of the respective patents, but in no event longer than the remaining legal life.

Warranty Costs

Estimated product performance costs are provided at the time of sale of the warranted product.

Pensions

Beginning in 1986, costs of U.S. pension plans, and gains and losses on settlements of liabilities under U.S. pension plans are determined in accordance with Statements of Accounting Standards No. 87 and No. 88. Beginning in 1987, Statements of Financial Accounting Standards No. 87 and No. 88 were adopted for Canadian pension plans. Pension cost for other foreign plans for the years ended October 31, 1988, 1987 and 1986 and for Canadian plans for the year ended October 31, 1986 were determined under prior accounting principles.

Note A — Summary of Significant Accounting Policies (continued)

Income

Deferred income taxes are provided for timing differences between income and expenses reported for financial statement purposes and tax purposes, and for income taxes payable upon the anticipated distribution of the earnings of foreign subsidiaries.

Investment tax credits are reflected as reductions of income tax expense in the years in which such credits arise or in the years they can be utilized.

Translation of Foreign Currencies

For subsidiaries in countries which do not have highly inflationary economies, asset and liability accounts are translated at the rate in effect at the balance sheet date, and revenue and expense accounts are translated at weighted average rates. Translation adjustments are reflected as a separate component of shareholders' investment.

For subsidiaries in countries with highly inflationary economies, inventories, cost of sales, property, plant and equipment and related depreciation are translated at historical rates. Other asset and liability accounts are translated at rates in effect at the balance sheet date, and revenues and expenses excluding cost of sales and depreciation are translated at weighted average rates. Translation adjustments are reflected in the statement of earnings.

Prior Year Financial Statements and New Accounting Standards

A statement of cash flows is included for 1988 as required by Statement of Financial Accounting Standards No. 95. Comparative cash flow statements for 1987 and 1986 are also included. For purposes of reporting cash flows, cash and cash equivalents include cash on hand and investments with maturities of three months or less.

Certain reclassifications have been applied to prior year financial statements to conform to the 1988 presentation.

The Financial Accounting Standards Board has issued certain accounting standards affecting the consolidation of majority-owned subsidiaries and accounting for income taxes and pension plans. The Company is not required to and has not yet fully adopted these standards, as discussed in the appropriate following notes.

Note B — Unconsolidated Subsidiaries and Affiliates

Discontinued Operations

On November 6, 1987, the Company sold its wholly-owned unconsolidated subsidiary, Reliance Standard Life Insurance Company, to RSL Holding Company, Inc., a wholly-owned subsidiary of Rosenkranz & Company, for an aggregate cash consideration of $220 million. The sale resulted in a net after-tax gain of $34.0 million or $.49 per share including $11.3 million or $.16 per share of tax benefits of loss carryforwards. The tax benefits are included in the extraordinary item and a charge equivalent to taxes is included in "Discontinued operations" on the 1988 statement of earnings.

On October 30, 1987, the Company's wholly-owned unconsolidated finance subsidiary, Dresser Finance Corporation, sold its leasing subsidiary, Dresser Leasing Corporation, to Sovran Leasing Corporation, a wholly-owned subsidiary of Sovran Financial Corporation, for a cash consideration of $37.8 million, which resulted in a gain of $5.6 million. As part of the transaction, Sovran Leasing Corporation repaid $77.8 million of outstanding intercompany loans from Dresser Leasing Corporation to Dresser Finance Corporation.

The operations of and gains on sales of Reliance Standard Life Insurance Company and Dresser Leasing Corporation are reported as discontinued operations in the consolidated statements of earnings.

Continuing Unconsolidated Subsidiaries and Affiliates

Effective September 1, 1988, the Company and Komatsu Ltd. combined their construction equipment businesses in the Western Hemisphere into a new company named the Komatsu Dresser Company. Komatsu Dresser Company is a general partnership and is owned 50 percent each by the Company and Komatsu. The Company contributed approximately $191.1 million of net assets including approximately $54.8 million of working capital in exchange for its ownership interest. The finance business and receivables of Dresser Finance Corporation and the capital shares of a wholly-owned unconsolidated equipment distribution subsidiary were included in the assets contributed.

Note B — Unconsolidated Subsidiaries and Affiliates (continued)

Continuing Unconsolidated Subsidiaries and Affiliates (continued)

Effective January 1, 1987, the Company and Ingersoll-Rand Company combined their compressor and turbine businesses and formed the Dresser-Rand Company. Dresser-Rand is a general partnership and is owned 50 percent each by the Company and Ingersoll-Rand. The Company contributed approximately $170 million of net assets including approximately $62 million of working capital in exchange for its ownership interest.

As of May 1, 1987, the Company and Litton Industries, Inc. combined the Company's Atlas Division and Litton's Resources Group into a new international oilfield service company named Western Atlas International, Inc. Western Atlas International, Inc. is owned 30 percent by the Company and 70 percent by Litton Industries, Inc. The Company contributed approximately $176 million of net assets including approximately $53 million of working capital in exchange for its ownership interest.

The Company's equity basis investments in Dresser-Rand, Komatsu Dresser and Western Atlas are included in "Investments in unconsolidated subsidiaries and affiliates". The Company's share of the earnings or losses of the Dresser-Rand and Komatsu Dresser partnerships are included in "Partnership operations". The Company's share of the earnings of Western Atlas is included in "Equity in earnings of unconsolidated subsidiaries and affiliates".

The Company will begin consolidating its remaining wholly-owned unconsolidated subsidiaries in 1989 as required by Statement of Financial Accounting Standards No. 94. Since the investments are currently accounted for on the equity basis, the change will not have a significant effect on the Company's financial position or results of operations.

The Company received cash dividends from the unconsolidated subsidiaries and 20% to 50% owned affiliates of $12.2 million in 1988, $13.1 million in 1987 and $3.4 million in 1986.

Investments in unconsolidated subsidiaries and affiliates include long-term advances of $6.5, $2.8, and $172.2 million at October 31, 1988, 1987 and 1986, respectively.

Summarized balance sheet, revenues and net earnings information for the 20% to 50% owned partnerships and affiliates and the wholly-owned equipment distributors is as follows (in millions):

	Dresser-Rand and Komatsu Dresser		All Other		
	1988	1987	1988	1987	1986
Receivables	$ 580.5	$117.2	$ 301.0	$ 324.1	$199.3
Inventories	847.8	260.1	191.9	245.5	214.2
Property, net	240.4	101.5	410.7	561.9	317.4
Other assets	97.3	122.8	302.9	307.9	76.8
Total assets	$1,766.0	$601.6	$1,206.5	$1,439.4	$807.7
Notes payable to banks	$ 445.2	$107.0	$ 116.4	$ 68.9	$ 71.3
Accounts payable	341.5	50.8	127.0	261.7	111.1
Other liabilities	392.0	196.0	254.7	308.6	230.0
Owners' equity	587.3	247.8	708.4	800.2	395.3
Total liabilities and owners' equity	$1,766.0	$601.6	$1,206.5	$1,439.4	$807.7
Investment					
Equity in net assets	$ 245.3	$ 99.0	$ 239.9	$ 254.6	$105.2
Loans and advances	—	—	6.5	2.8	11.3
	$ 245.3	$ 99.0	$ 246.4	$ 257.4	$116.5
Revenues	$ 897.9	$565.4	$1,277.7	$ 748.8	$713.3
Costs and expenses	$ 896.0	$655.0	$1,226.8	$ 794.5	$767.7
Equity in net earnings (loss)	$ 1.0	$(36.8)	$ 9.7	$ 1.7	$ (.1)

Note B — Unconsolidated Subsidiaries and Affiliates (continued)

Continuing Unconsolidated Subsidiaries and Affiliates (continued)

The Company's investment in Dresser-Rand and Komatsu Dresser is reduced by asset valuation reserves and negative goodwill, which existed before the establishment of the partnerships. The valuation reserves are being released to earnings as the related assets are sold by the partnerships. The negative goodwill is being amortized over ten years.

Summarized balance sheet, revenues and net earnings information for the wholly-owned unconsolidated financial service, insurance and real estate subsidiaries and a 50% owned real estate partnership is as follows (in millions):

	Continuing			Discontinued*	
	1988	1987	1986	1987	1986
Cash and short-term investments	$58.4	$116.4	$ 64.6	$632.7	$565.6
Receivables	13.2	109.2	177.4	17.0	181.2
Property, net	21.4	22.1	38.2	1.4	18.2
Other assets	2.7	.6	6.8	85.9	139.7
Total assets	$95.7	$248.3	$287.0	$737.0	$904.7
Policy reserves	$ —	$ —	$ —	$473.6	$446.7
Notes payable to banks	29.6	61.6	45.1	—	29.4
Mortgage loans	—	30.7	38.3	—	1.3
Other liabilities	55.5	117.4	127.6	87.4	249.9
Owners' equity	10.6	38.6	76.0	176.0	177.4
Total liabilities and owners' equity	$95.7	$248.3	$287.0	$737.0	$904.7
Investment					
Equity in net assets	$13.1	$ 40.4	$ 56.3	$173.3	$183.8
Loans and advances	—	—	156.1	—	4.8
	$13.1	$ 40.4	$212.4	$173.3	$188.6
Revenues	$31.8	$ 69.4	$ 67.9	$246.7	$233.5
Costs and expenses	$25.9	$ 53.7	$ 60.0	$227.6	$205.0
Equity in net earnings	$ 4.9	$ 8.1	$ 7.9	$ 26.7	$ 25.6

*Reliance Standard Life Insurance Company and Dresser Leasing Corporation.

Note C — Business Combinations

On January 11, 1988, the Company acquired substantially all of the business of The M. W. Kellogg Company, a process engineering and construction firm, from The Henley Group, Inc. for a cash outlay of $114.1 million and the assumption of non-interest bearing liabilities of $345.5 million. The acquisition has been accounted for as a purchase and, accordingly, the consolidated statement of earnings includes the results of operations since the date of acquisition. The acquisition cost exceeded the fair value of the net assets acquired by approximately $256.0 million. The excess was recorded as goodwill and is being amortized on a straight-line basis over forty years (Note F).

The following table presents unaudited pro forma earnings statement information for the years ended October 31, 1988 and 1987, as if the acquisition had occurred on November 1, 1986. An adjustment has been made for the estimated increases in depreciation and amortization of the related assets. The pro forma results do not necessarily indicate what would have occurred had the acquisition been on November 1, 1986 or the results that may occur in the future.

Notes to Consolidated Financial Statements (continued)

Note C — Business Combinations (continued)

In millions, except per share amounts (Unaudited)	Pro Forma 1988	Pro Forma 1987
Sales and service revenues	$4,194.6	$4,073.4
Earnings before extraordinary item	149.3	63.9
Net earnings	160.6	70.4
Earnings per share		
Before extraordinary item	$ 2.16	$ .85
Net earnings	2.32	.93

As of December 1, 1986, the Company and the Halliburton Company combined their drilling fluid operations and formed M-I Drilling Fluids Company, which is a partnership owned 60 percent by the Company and 40 percent by Halliburton. M-I Drilling Fluids is included as a consolidated subsidiary. Halliburton's equity is included in the Minority Interest accounts on the 1988 and 1987 balance sheets and statements of earnings. Halliburton contributed approximately $75 million of net assets, including approximately $45 million of working capital, for its investment.

As of September 1, 1987, the Company and Geolograph-Pioneer, Inc. combined the Company's Swaco operations and Geolograph-Pioneer, Inc.'s fluids processing, pressure control and rig instrumentation businesses into a new partnership named Swaco Geolograph Company. The new partnership is owned 65 percent by the Company and 35 percent by Geolograph-Pioneer, Inc. and is included as a consolidated subsidiary. Geolograph-Pioneer's equity is included in the Minority Interest accounts on the 1988 and 1987 balance sheets and statements of earnings. The amount of net assets and working capital contributed by Geolograph-Pioneer were not material.

In 1986, the Company purchased a distributor of the Company's construction equipment for $22.0 million. Also in 1986, the Company purchased the remaining 50 percent interest in a foreign subsidiary.

Note D — Long-Term Contracts

The accounts receivable do not include any significant amounts of excess of costs and related profits over amounts billed nor any significant amounts billed but not paid by customers under retainage provisions.

Service revenues and cost of services include the value of materials, equipment and labor contracts furnished by customers for which the Company is responsible for the ultimate acceptability of performance of the project based on such material, equipment or labor. The value of such items was $221.6 million for the year ended October 31, 1988.

Note E — Inventories

Inventories on the LIFO method were $162.3, $268.1 and $374.2 million at October 31, 1988, 1987 and 1986, respectively. Under the average cost method, inventories would have increased by $143.4, $184.3 and $232.6 million at October 31, 1988, 1987 and 1986, respectively.

During 1987 and 1986, the Company experienced significant quantity reductions in some of the LIFO inventories which were carried at lower costs that prevailed in prior years. The quantity reductions reduced cost of sales by $59.9 million in 1987 and $48.7 million in 1986. Since no U.S. income taxes were provided in 1987 and 1986 (See Note G), the quantity reductions increased net earnings in 1987 by $59.9 million or $.80 per share and reduced the net loss in 1986 by $48.7 million or $.64 per share. Quantity reductions during 1988, except for inventories contributed to the Komatsu Dresser partnership, were not significant (Note B).

Finished products and work in process inventories are stated net of progress payments on contracts of $10.6, $11.5 and $51.1 million at October 31, 1988, 1987 and 1986, respectively.

Note F — Intangibles

Intangibles relate to businesses acquired and consist principally of the difference between purchase price and fair value at date of acquisition of net assets purchased (goodwill). The January 11, 1988 purchase of the business and net assets of The M. W. Kellogg Company added $256.0 million to goodwill (Note C).

Note G — Income Taxes

The components of earnings before income taxes are summarized below (in millions):

	1988	1987	1986
Domestic	$ 74.5	$(18.7)	$(92.0)
Foreign	104.1	58.0	114.8
	$178.6	$ 39.3	$ 22.8

Taxes on income consisted of the following (in millions):

	1988	1987	1986
Current			
U.S. Federal	$ 3.7	$ —	$(16.7)
State	1.0	2.2	1.7
Foreign	70.0	41.8	63.2
	74.7	44.0	48.2
Deferred Foreign	(10.6)	4.0	4.3
	$ 64.1	$ 48.0	$ 52.5

The 1987 current foreign taxes of $41.8 million contain a charge of $5.9 million equivalent to income taxes which would have been incurred had foreign operating loss carryforwards not been available. The income tax benefit resulting from utilizing the operating loss carryforwards is presented as an extraordinary credit. The Company recognized in 1987 and 1986 only those U.S. Federal tax benefits that can be realized by refund of taxes previously paid.

At October 31, 1988, the Company had approximately $204 million of operating loss carryforwards available to reduce future U.S. Federal income taxes for financial reporting purposes. There are no domestic operating loss carryforwards available for tax reporting purposes. In addition, the Company had approximately $20 million of capital losses available for both financial and U.S. Federal tax reporting purposes, expiring in 1992. At October 31, 1988, foreign operating loss carryforwards approximated $100 million, of which approximately $45 million carry forward indefinitely, and the remaining amounts expire at various dates from 1989 to 1994.

The Company plans to continue to finance foreign operations and expansion by reinvestment of undistributed earnings of its foreign subsidiaries (approximately $335 million at October 31, 1988); accordingly, no taxes which might be payable upon distribution of such earnings have been provided.

The following is a reconciliation of income taxes at the U.S. Federal income tax rate to the income taxes reflected in the Consolidated Statements of Earnings (in millions):

	1988	1987	1986
Income taxes at the U.S. Federal income tax rate of 34% for 1988, 42% for 1987 and 46% for 1986	$ 60.7	$ 16.5	$ 9.0
Minority interest's share of operations	(2.2)	4.3	—
Investment tax credit	—	—	1.1
Foreign sales corporation	(1.7)	—	(6.4)
Statutory depletion	(1.6)	(2.1)	(1.5)
Foreign taxes in excess of U.S. tax rate on foreign earnings	11.9	19.2	16.0
Charge equivalent to foreign income taxes	—	5.9	9.1
Benefit of tax basis of property in excess of book value	(12.2)	(1.9)	(2.3)
Tax benefits not recognized subject to future realization	—	1.3	19.5
Other	9.2	4.8	8.0
Total income taxes	$ 64.1	$ 48.0	$ 52.5

Notes to Consolidated Financial Statements (continued)

Note G — Income Taxes (continued)

The deferred income tax provisions (credits) resulted from timing differences related to the following (in millions):

	1988	1987	1986
Unrepatriated foreign earnings	$ —	$ —	$ 3.4
Pension liability	—	3.5	—
Other items including warranty, insurance and similar accruals	(10.6)	.5	.9
Total income taxes	$(10.6)	$ 4.0	$ 4.3

Income taxes paid during the years ended October 31, 1988, 1987 and 1986 amounted to (in millions) $80.9, $41.2 and $49.9, respectively. Income tax refunds during the years ended October 31, 1988, 1987 and 1986 amounted to (in millions) $2.1, $11.2 and $45.5, respectively.

Statement of Financial Accounting Standards No. 96 was issued in December 1987 and amended in December 1988. It requires the Company to make changes in accounting for income taxes no later than fiscal year 1991. The Company does not expect to adopt the statement before fiscal year 1991. Due to the complexity of the changes, it is not possible at this time to estimate the effect of the changes on the Company's financial position and results of operations; however, a significant amount of the deferred income taxes at October 31, 1988 will be charged to Shareholders' investment or earnings.

Note H — Short-Term Debt

Lines of credit for short-term borrowings aggregating $140.0 million at October 31, 1988, have been established with banks within the United States. Such lines provide for borrowings at the prevailing prime interest rate. The lines of credit may be used by the Company and certain foreign subsidiaries, and include Eurodollars and foreign currencies. The lines of credit may be terminated at the option of the banks or the Company.

Loan arrangements have been established with banks outside the United States, under which the Company's foreign subsidiaries may borrow on an overdraft and short-term note basis. At October 31, 1988 the amount available and unused under these arrangements aggregated $89.1 million.

Substantially all short-term debt consisted of borrowings from foreign banks at October 31, 1988, 1987 and 1986.

The Company has understandings with certain of the banks regarding deposit balances as compensation for credit arrangements, but the aggregate amount of such compensating balances was not material at October 31, 1988. The Company was not legally restricted from withdrawing all or any portion of the compensating balances at any time during the year ended October 31, 1988.

Note I — Long-Term Debt

Long-term debt is summarized as follows (in millions):

	October 31,		
	1988	1987	1986
Sinking fund debentures, 11¾%, due 2007	$125.0	$125.0	$125.0
Sinking fund debentures, 9⅝%, due 1995	11.4	16.8	20.4
Sinking fund debentures, 9⅝%, due 2000	68.8	68.9	74.8
Eurodollar notes, 12½%	—	—	75.0
Notes payable, 7½%	—	—	12.0
Notes payable under institutional loan agreements, 8%, due in annual installments to June 1997	20.0	22.1	24.2
Other loan agreements, 4.0% to 16.0%, due in installments to 2009	40.6	52.6	58.9
	265.8	285.4	382.3
Less portion due within one year	10.6	14.3	23.6
	$255.2	$271.1	$358.7

Maturities of principal and sinking fund payments for the five years subsequent to October 31, 1988 amount to (in millions) $10.6 in 1989, $12.2 in 1990, $13.0 in 1991, $13.1 in 1992 and $22.8 in 1993.

Note I — Long-Term Debt (continued)

The debentures due 2007 have mandatory annual sinking fund payments of $8.3 million beginning in 1993. The debentures due 1995 have mandatory annual sinking fund payments of $3.3 million, which have been satisfied through 1991. In addition, $2.1 million of the 1992 requirement has been met. The debentures due 2000 have mandatory annual sinking fund payments of $6.4 million, which have been satisfied through 1989. In addition, $5.6 million of the 1990 requirement has been met.

The loan agreements and indentures contain requirements for the maintenance of working capital and certain restrictions on the payment of dividends. As of October 31, 1988, consolidated retained earnings of $1,152.8 million were free of dividend restrictions under the most restrictive of these provisions.

Interest paid during the years ended October 31, 1988, 1987 and 1986 amounted to (in millions) $71.7, $62.6 and $76.3, respectively.

Note J — Employee Incentive Plans

The 1982 Stock Option Plan provides for the granting of options to executives and key employees for purchase of the Company's common shares. The Plan is administered by a committee consisting of seven Directors, none of whom is an officer of the Company. The committee designates any requirement as to waiting period or exercise date. No option can be for a term of more than ten years from date of grant. The option price is recommended by the committee, but cannot be less than 100% of the average price of the shares on the New York Stock Exchange on the day the options are granted. Changes in outstanding options during 1988 and options exercisable at October 31, 1988 under both the 1982 plan and the predecessor 1972 plan are as follows:

Outstanding at November 1, 1987	633,683
Options granted at $22.9375	56,400
Options exercised at $18.25 to $32.8125	(112,956)
Options cancelled or expired	(25,875)
Outstanding at October 31, 1988	551,252
Exercisable at $18.25 to $32.8125	389,050

Shares reserved for granting of future options under the 1982 plan were 2,447,250 shares at October 31, 1987 and 2,418,225 shares at October 31, 1988. At October 31, 1988, a total of 2,969,477 shares were reserved for options outstanding and future options.

Under the terms of the employee Stock Purchase Plan, salaried employees working in the United States and United States citizens working outside the United States for certain foreign subsidiaries, except officers and directors of the Company and certain employees represented by a union or participating in other thrift or savings plans, may purchase the Company's common stock through payroll deductions. Discounts from market price of up to 15% are allowed depending on the employee's length of service. The difference between the employee's purchase price and current market value is paid by the Company.

Under the Deferred Compensation Plan, a portion of the incentive compensation for officers and key employees can be deferred for payment after retirement or termination of employment, either in common shares of the Company, or in cash at the equivalent market value of the common shares. The accrued deferred compensation liability may be satisfied by the future issuance of authorized but unissued common shares or treasury shares.

Officers and key employees of the Company are eligible to participate in the Performance Stock Unit Plan. The Executive Compensation Committee of the Board of Directors, whose members are not eligible for an Award under the Plan, selects the employees to participate in the Plan and the number of Stock Units to be granted to each. Each Award of Stock Units covers an Award Cycle of four consecutive fiscal years of the Company beginning on November 1, 1985 and each odd-numbered year thereafter. For each Award Cycle, the Board of Directors establishes the performance objective on which payment of Awards is conditioned. Such objective may include, but is not limited to, average annual return on investment, earnings per share, earnings before taxes, or other criteria, or a combination thereof. Following the end of an Award Cycle, the Executive Compensation Committee determines whether the objective is met for such Award Cycle and, if so, whether Awards are paid in cash or stock, or some combination of cash and stock. In 1988, 70,400 contingent Stock Units were granted for the Award Cycle ending October 31, 1991 and in 1986, 115,191 contingent Stock Units were granted for the Award Cycle ending October 31, 1989.

Note K — Capital Shares

The authorized shares of the Company consist of 200,000,000 common shares and 10,000,000 preferred shares.

Changes in issued common shares during the three years ended October 31, 1988 are as follows:

Shares at November 1, 1985	82,215,649
Issued in connection with employee benefit and dividend reinvestment plans	593,320
Shares at October 31, 1986	82,808,969
Issued in connection with employee benefit and dividend reinvestment plans	146,180
Shares at October 31, 1987	82,955,149
Issued in connection with employee benefit and dividend reinvestment plans	69,075
Shares at October 31, 1988	83,024,224

Changes in common shares held as Treasury shares during the three years ended October 31, 1988 are as follows:

Treasury shares at November 1, 1985	5,992,257
Purchased	1,180,364
Treasury shares at October 31, 1986	7,172,621
Purchased	4,072,135
Issued in connection with employee benefit plans	(349,262)
Treasury shares at October 31, 1987	10,895,494
Purchased	5,252,314
Issued in connection with employee benefit plans	(364,749)
Treasury shares at October 31, 1988	15,783,059

At October 31, 1988, all treasury shares were available to satisfy obligations under the Deferred Compensation Plan and employee incentive plans (See Note J).

Under the terms of the automatic dividend reinvestment plan, holders of common shares may have their cash dividends automatically reinvested in the Company's common shares, or they may invest both their cash dividends and up to $1,000 per month of optional cash payments in the Company's common shares. All share purchases are without payment of any brokerage commissions or service charges.

On April 17, 1986, the Directors declared a dividend distribution of one Right for each outstanding share of Common Stock. The Rights were issued on April 28, 1986, to shareholders of record on April 28, 1986, and expire in ten years. Initially, the Rights are not exercisable, certificates have not been issued, and the Rights automatically trade with the Common Stock. However, ten days after a person or group either acquires 20% or more of the Company's Common Stock, or commences a tender offer that would result in such person or group owning 30% or more of the outstanding shares, the Rights will become exercisable, and separate certificates representing the Rights will be distributed. The Rights have no voting power.

When the Rights first become exercisable, a holder will be entitled to buy one one-hundredth of a share of a new series of Junior Participating Preferred Stock at a purchase price of $60. If the Company is involved in a merger or other business combination at any time when there is a 20% or more stockholder of the Company, the Rights entitle a holder to buy a number of shares of common stock of the acquiring company having a market value of twice the exercise price of each Right. Alternatively, if a 20% holder acquires the Company by means of a reverse merger, in which the Company and its stock survive, or if any person acquires 30% or more of the Company's Common Stock (other than pursuant to a tender offer or exchange offer for all outstanding shares), each Right not owned by a 20% or more shareholder would become exercisable for Common Stock of the Company (or, in certain circumstances, other consideration of the Company) having a market value equal to twice the exercise price of the Right.

The Rights may generally be redeemed by the Company at five cents per Right prior to the time any person or group has acquired 20% or more of the Company's Common Stock.

Note L — Commitments and Contingencies

Litigation

The Company has been engaged in patent-related litigation with the Hughes Tool Company and its successor, Baker Hughes Incorporated (Hughes). Hughes charged the Company with infringement of two U.S. patents relating to structure within a journal bearing rock bit. On July 21, 1988, the Company and Baker Hughes Incorporated reached an agreement settling the litigation. Under the terms of the agreement, Baker Hughes received the Company's 27.66% interest in BJ-Titan Services Company, a partnership owned by the Company and Baker Hughes, and $23 million in cash. Based on this settlement, on August 1, 1988, the District Court entered an order dismissing the litigation.

The Company and its subsidiaries are involved in certain other legal actions and claims arising in the ordinary course of their business. It is the opinion of management (based on advice of legal counsel) that such litigation and claims will be resolved without material effect on the Company's financial position.

Other

The Company and certain subsidiaries are contingently liable as guarantors of obligations aggregating approximately $37.5 million at October 31, 1988.

Total rental and lease expense charged to earnings was $73.1 million in 1988, $65.6 million in 1987 and $79.5 million in 1986. At October 31, 1988, the aggregate minimum annual obligations under noncancelable leases were (in millions): $34.6 for 1989; $29.0 for 1990; $25.2 for 1991; $19.6 for 1992; $15.9 for 1993; and $80.3 for all subsequent years. The lease obligations relate primarily to general and sales office space and warehouses, including 15 years remaining on the lease for office space in the Dresser-Cullen Venture (50% owned. See Note B) building at a current annual rate of approximately $4.2 million subject to escalation for operating costs. The effect on the Company's financial position or results of operations would not be significant if existing capital type leases were capitalized and amortized over the lease periods.

Note M — Pension Plans and Retiree Benefits

U.S. and Canadian Pension Plans

The Company and its subsidiaries have pension plans covering substantially all U.S. and Canadian employees. The benefits for the plans covering the salaried employees are based primarily on years of service and employees' qualifying compensation during the final years of employment. The benefits for the plans covering the hourly employees are based primarily on years of service. The Company's funding policy is consistent with the funding requirements of Federal law and regulations. About 90% of the plan assets are invested in cash, short-term investments, listed stocks, and bonds. The rest of the plan assets are primarily invested in real estate and insurance contracts purchased from life insurance companies.

The 1988, 1987 and 1986 pension costs (credit) include the following components (in millions):

	1988	1987	1986
Service cost for benefit earned during the period	$ 12.7	$ 19.6	$ 17.3
Interest cost on projected benefit obligation	25.3	30.8	56.0
Actual return on plan assets	(22.9)	(28.4)	(63.3)
Net amortization and deferral	(8.6)	(10.2)	(17.8)
Joint venture adjustments	(1.0)	(5.2)	—
Net pension costs (credit)	$ 5.5	$ 5.6	$ (7.8)

Notes to Consolidated Financial Statements (continued)

Note M — Pension Plans and Retiree Benefits (continued)

U.S. and Canadian Pension Plans (continued)

The assumptions used to develop the net pension costs (credit) for 1988, 1987 and 1986 were:

	1988	1987	1986
Discount rate	8.75%	8.75%	10.00%
Expected long-term rate of return on assets	9.00%	9.00%	9.00%
Rate of increase in compensation levels	5.50%	5.50%	5.50%

In 1986, the Company adopted Statement of Financial Accounting Standards No. 87 (SFAS 87), "Employers' Accounting for Pensions". Pension costs for 1986 under SFAS 87 were a $7.8 million credit and were $38.6 million ($.50 per share) lower than they would have been under the previous accounting standards.

Effective May 1, 1986, the Company terminated its U.S. pension plans for salaried employees in connection with a reversion of the plans' surplus funds and adopted a successor pension plan with a different benefit formula. The salaried retirement plans purchased an annuity contract for approximately 18,000 members of the pension plans guaranteeing the payment of their future pension benefits. In connection with this termination, approximately $129.0 million of plan assets reverted to the Company. The Company also terminated certain hourly pension plans during 1988, 1987 and 1986 and $13.0 million, $58.9 million and $5.1 million, respectively, of plan assets reverted to the Company.

The Company adopted Statement of Financial Accounting Standards No. 88 (SFAS 88), "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits". In accordance with requirements of SFAS 88 concerning settlement of plan liabilities, the Company recognized gains of $13.6 million, $88.9 million and $61.7 million for the years ended October 31, 1988, 1987 and 1986, respectively. The difference between the assets which reverted to the Company and the total gains of $164.2 million is included in long-term pension plan liabilities.

The effect of the adoption in 1987 of Statement of Financial Accounting Standards No. 87 and No. 88 for the Canadian pension plans was not significant.

The funded status of the plans on the measurement dates, August 1, 1988, 1987 and 1986, was as follows (in millions):

Plans with Assets Exceeding Accumulated Benefits	1988	1987	1986
Actuarial present value of benefit obligations:			
Vested benefit obligation	$ 133.1	$ 151.6	$ 234.7
Accumulated benefit obligation	$ 137.0	$ 157.3	$ 248.3
Projected benefit obligation	$ 139.1	$ 159.6	$ 248.7
Plan assets at fair value	215.1	241.0	389.9
Projected benefit obligation (over) under plan assets	76.0	81.4	141.2
Unrecognized net (gain) loss	(4.9)	(.5)	(29.8)
Prior service cost not yet recognized in net periodic pension cost	5.1	5.2	.3
Remaining unrecognized net (asset) obligation existing at date of adoption of SFAS 87	(48.1)	(64.3)	(108.9)
Prepaid pension costs (pension liability) recognized as of August 1	$ 28.1	$ 21.8	$ 2.8

Note M — Pension Plans and Retiree Benefits (continued)

U.S. and Canadian Pension Plans (continued)

Plans with Accumulated Benefits Exceeding Assets	1988	1987	1986
Actuarial present value of benefit obligations:			
Vested benefit obligation	$ 75.4	$ 48.3	$ 11.3
Accumulated benefit obligation	$ 79.9	$ 55.1	$ 15.5
Projected benefit obligation	$ 129.5	$ 120.3	$ 116.7
Plan assets at fair value	52.6	22.6	1.9
Projected benefit obligation (over) under plan assets	(76.9)	(97.7)	(114.8)
Unrecognized net (gain) loss	.2	5.6	16.2
Prior service cost not yet recognized in net periodic pension cost	(2.9)	4.1	.1
Remaining unrecognized net (asset) obligation existing at date of adoption of SFAS 87	(20.9)	(18.0)	(17.9)
Prepaid pension costs (pension liability) recognized as of August 1	$(100.5)	$(106.0)	$(116.4)

The current portion of pension liability is included in "Accrued compensation and benefits".

The assumptions used to develop the projected benefit obligation in 1988, 1987 and 1986 were:

Discount rate	8.75%
Expected long-term rate of return on assets	9.00%
Rate of increase in compensation levels	5.50%

Defined Contribution Plans

A wholly-owned and a majority-owned subsidiary maintain defined contribution plans for most U.S. salaried employees. Under these plans, eligible employees may contribute amounts through payroll deductions supplemented by employer contributions for investment in various funds established by the plans. The cost of these plans was $4.1 million in 1988.

Non-U.S. and Non-Canadian Pension Plans

Pension coverage for employees of the Company's non-U.S. and non-Canadian consolidated subsidiaries is provided, to the extent deemed appropriate, through separate plans. Obligations under such plans are systematically provided for by depositing funds with trustees, under insurance policies or by book reserves. The pension expense for these plans was $5.6 million, $6.5 million and $6.1 million for 1988, 1987 and 1986, respectively. The actuarial present value of accumulated plan benefits at October 31, 1988 was $69.5 million (of which $2.8 million was non-vested) compared with net assets available for benefits of $106.8 million. The assumed average rate of return used in determining the actuarial present value of benefits was 8.7%. The Company must apply SFAS 87 to these foreign based pension plans no later than fiscal year 1990. Due to the complexity of the changes and the number of countries and plans involved, the Company has not determined when the statement will be adopted, or the effect it will have on the Company's financial position and results of operations.

Consolidated Company

On a consolidated basis, pension costs (credits) were $15.2 million in 1988, $12.1 million in 1987 and $(1.7) million in 1986.

Retiree Benefits

In addition to providing pension benefits, the Company and its subsidiaries provide certain health care and life insurance benefits for retired employees. Most of the employees who retire from the Company are eligible for these benefits. The cost of retiree health care is recognized as an expense as claims are paid, and the cost of retiree life insurance is recognized by expensing the annual insurance premiums. These costs totaled $19.8 million in 1988, $15.7 million in 1987 and $15.9 million in 1986.

Notes to Consolidated Financial Statements (continued)

Note N — Special Charges and Supplementary Income Statement Information

Special Charges

During 1985 and 1986, significant uncertainties in the markets for certain products and services related to oil and gas, steel, and mining caused the Company to evaluate existing and continued investment and support of products for these industries. A special charge of $25.3 million was made in the third quarter of 1986 to write-down the excess equipment. See Note O for information concerning the amount of the special charges by segment of the Company's business and geographical locations.

Supplementary Income Statement Information

Earnings per common share are based on the average number of common shares outstanding during each period. The average common shares outstanding were 69.1 million in 1988, 75.3 million in 1987 and 76.6 million in 1986. Outstanding stock options and other common stock equivalents do not have a material effect on earnings per share.

Depreciation, depletion and amortization of property, plant and equipment charged to earnings amounted to $93.4 million in 1988, $120.5 million in 1987 and $160.9 million in 1986.

Research and development costs charged to earnings amounted to $27.4 million in 1988, $32.4 million in 1987 and $62.9 million in 1986.

The year-to-year decreases in depreciation, depletion and amortization charges and in research and development costs are primarily due to the transfers of certain operations to the Dresser-Rand and Western Atlas joint ventures (Note B).

Net foreign exchange adjustments, including gains and losses from both settlement of commercial transactions and translation adjustments for highly inflationary countries (primarily Argentina, Brazil and Mexico), resulted in net losses of $13.4 million in 1988 and $7.1 million in 1987 and net gains of $7.1 million in 1986. Net foreign exchange adjustments are included in "Other income (deductions)".

Note O — Information by Industry Segment and Geographic Area

On January 11, 1988, the Company acquired substantially all of the business of The M. W. Kellogg Company, a process engineering and construction firm (Note C). A new Engineering Services Segment is reported for 1988 consisting of the acquired Kellogg operations and the environmental products operations that were formerly in the Energy Processing and Conversion Equipment Segment.

The former Petroleum Operations Segment has been renamed the Oilfield Operations Segment. During 1988, the gasoline dispensing systems business was transferred from the Oilfield Operations Segment to the Energy Processing and Conversion Equipment Segment and the metals mining business was transferred from the Oilfield Operations Segment to the General Industry Segment.

Prior year data have been restated to conform to the current segment alignment. The Company's five industry segments are as follows:

Oilfield Operations

This segment provides products and technical services for oil and gas well exploration, drilling and production operations. Principal products and services include drilling fluid systems, rock bits, downhole production tools, petroleum services — integrated reservoir description, seismic services, core analysis, wireline logging services — and workover/drilling rigs. On May 1, 1987, certain petroleum services assets were transferred to Western Atlas International, Inc. (Note B). On December 1, 1986, the Company and Halliburton combined their drilling fluids businesses to form M-I Drilling Fluids Company (Note C).

Energy Processing and Conversion Equipment

This segment provides products and systems utilized in oil and gas production; oil and gas pipelines; the processing or conversion of oil, gas and coal into other energy forms; and marketing operations. Major products, services and systems include compressors, pumps, steam turbines, diesel engines, measurement and control devices and gasoline dispensing systems. On January 1, 1987, certain compressor and steam turbine operations were transferred to Dresser-Rand Company (Note B).

Note O — Information by Industry Segment and Geographic Area (continued)

Engineering Services
This segment provides engineering, construction and related services primarily to the hydrocarbon process industries. It also designs, produces and installs pollution control equipment in coal-fired power plants.

Mining and Construction Equipment
This segment is a producer of equipment for mining, earth moving and road maintenance operations primarily conducted by the coal and construction industries. Major products include walking draglines, continuous mining machines, compaction rollers, motor graders, wheel loaders, crawler tractors, excavators and off-highway trucks. On September 1, 1988, construction equipment operations in the Western Hemisphere were transferred to Komatsu Dresser Company (Note B).

General Industry
This segment provides products for industrial and commercial applications that are used both as end products and as components of other products or systems. Products include refractories, pipe fittings and couplings, pneumatic tools and refined lead and related minerals. The abrasive product operations were sold as of June 30, 1988.

Total revenues include sales and services to unaffiliated customers and either intersegment sales and services or intergeographic area sales and services. The intersegment and intergeographic area sales and services are accounted for at prices which approximate arm's length market prices. No single customer accounted for 10 percent or more of total sales and service revenues.

Operating profit consists of total revenues less total operating expenses. General corporate expenses, pension plan settlements, interest expense, income taxes and equity in undistributed earnings of unconsolidated subsidiaries and affiliates have been excluded in determining operating profit. Identifiable assets are those assets that are identified with particular segments or geographic areas. Corporate assets are principally cash, short-term investments and receivables.

The financial information by Industry Segment and by Geographic Area for the years ended October 31, 1988, 1987 and 1986 is as follows (in millions):

	1988	1987	1986
Industry Segment			
Sales and service revenues to unaffiliated customers			
Oilfield Operations	$ 553.9	$ 513.4	$ 683.0
Energy Processing & Conversion Equipment	1,282.8	1,197.9	1,514.9
Engineering Services	742.5	45.3	54.6
Mining & Construction Equipment	863.7	899.5	949.2
General Industry	498.8	463.6	459.6
Intersegment sales and service revenues			
Oilfield Operations	—	.6	.2
Energy Processing & Conversion Equipment	5.6	1.7	23.0
Mining & Construction Equipment	—	.1	.5
General Industry	.9	.2	.5
Eliminations	(6.5)	(2.6)	(24.2)
Total sales and service revenues	$3,941.7	$3,119.7	$3,661.3

Notes to Consolidated Financial Statements (continued)

Note O — Information by Industry Segment and Geographic Area (continued)

	1988	1987	1986
Industry Segment (continued)			
Operating profit			
Oilfield Operations	$ 41.9	$ (54.8)	$ (46.0)
Energy Processing & Conversion Equipment	110.3	111.2	75.1
Engineering Services	18.6	2.8	8.5
Mining & Construction Equipment	13.4	(18.0)	27.5
General Industry	80.1	61.0	18.1
Adjustments and eliminations	(.1)	(1.7)	(2.9)
Subtotal	264.2	100.5	80.3
Special charges — Oilfield Operations	—	—	(25.3)
Partnership operations			
Energy Processing & Conversion Equipment	.5	(36.8)	—
Mining & Construction Equipment	.5	—	—
Total operating profit	265.2	63.7	55.0
General corporate expenses	(50.2)	(50.6)	(48.0)
Other non-segment expenses	(44.9)	(1.2)	(7.8)
Pension plan settlements	13.6	88.9	61.7
Interest expense, net	(5.1)	(61.5)	(38.1)
Earnings before taxes	$ 178.6	$ 39.3	$ 22.8
Equity earnings			
Oilfield Operations	$ 10.5	$ 2.2	$ 3.3
Energy Processing & Conversion Equipment	(1.1)	.3	(4.9)
Engineering Services	.2	—	—
Mining & Construction Equipment	.1	.6	2.5
General Industry	—	(1.4)	(1.0)
Finance, Insurance and Real Estate unconsolidated subsidiaries	4.9	8.1	7.9
Equity earnings from continuing operations	14.6	9.8	7.8
Discontinued operations	22.7	26.7	25.6
Total equity earnings	$ 37.3	$ 36.5	$ 33.4
Identifiable assets			
Oilfield Operations	$ 399.8	$ 394.1	$ 550.5
Energy Processing & Conversion Equipment	766.4	852.3	1,004.1
Engineering Services	365.2	23.3	19.2
Mining & Construction Equipment	462.7	542.6	491.8
General Industry	210.4	278.4	280.5
Adjustments and eliminations	(31.7)	(35.7)	(27.8)
Total identifiable assets	2,172.8	2,055.0	2,318.3
Equity investments			
Oilfield Operations	209.2	207.0	43.6
Energy Processing & Conversion Equipment	135.8	126.4	33.8
Engineering Services	.7	—	—
Mining & Construction Equipment	139.8	19.5	32.6
General Industry	2.3	3.5	6.5
Finance, Insurance and Real Estate unconsolidated subsidiaries	17.0	40.4	401.0
Equity investment in continuing operations	504.8	396.8	517.5
Discontinued operations	—	173.3	—
Total equity investments	504.8	570.1	517.5
Corporate assets	221.8	257.2	274.4
Total assets	$2,899.4	$2,882.3	$3,110.2

Note O — Information by Industry Segment and Geographic Area (continued)

	1988	1987	1986
Industry Segment (continued)			
Capital expenditures			
Oilfield Operations	$ 10.1	$ 7.0	$ 24.0
Energy Processing & Conversion Equipment	29.1	22.5	26.6
Engineering Services	4.8	.3	.4
Mining & Construction Equipment	8.4	10.2	10.3
General Industry	8.6	6.7	8.0
Corporate	1.5	10.7	1.8
Total capital expenditures	$ 62.5	$ 57.4	$ 71.1
Depreciation, depletion and amortization			
Oilfield Operations	$ 25.0	$ 55.4	$ 81.1
Energy Processing & Conversion Equipment	31.7	34.5	50.8
Engineering Services	13.7	.4	.3
Mining & Construction Equipment	7.6	7.1	5.2
General Industry	13.6	16.7	17.8
Corporate	5.3	6.3	6.8
Total depreciation, depletion and amortization	$ 96.9	$ 120.4	$ 162.0
Geographic Area			
Sales and service revenues to unaffiliated customers			
United States	$2,247.0	$1,966.1	$2,374.3
Canada	236.9	166.9	231.0
Latin America	215.5	164.7	175.6
Europe	808.2	664.4	691.4
Mid East, Far East and Africa	434.1	157.6	189.0
Intergeographic area sales and service revenues			
United States	183.2	163.7	197.6
Canada	75.9	73.6	60.3
Latin America	14.0	17.7	12.7
Europe	22.9	54.5	57.7
Mid East, Far East and Africa	1.7	5.5	60.6
Eliminations	(297.7)	(315.0)	(388.9)
Total sales and service revenues	$3,941.7	$3,119.7	$3,661.3
Operating profit			
United States	$ 154.1	$ (2.7)	$ (49.0)
Canada	27.7	13.0	21.7
Latin America	28.8	17.1	18.9
Europe	28.2	57.7	57.2
Mid East, Far East and Africa	28.0	8.7	23.3
Adjustments and eliminations	(2.6)	6.7	8.2
Subtotal	264.2	100.5	80.3
Special charges			
United States	—	—	(23.3)
Canada	—	—	(2.0)
Partnership operations			
United States	(3.9)	(28.8)	—
Canada	.4	.1	—
Latin America	1.0	(2.2)	—
Europe	2.4	(6.7)	—
Mid East, Far East and Africa	1.1	.8	—
Total operating profit	$ 265.2	$ 63.7	$ 55.0

Note O — Information by Industry Segment and Geographic Area (continued)

	1988	1987	1986
Geographic Area (continued)			
Equity earnings			
United States	$ 10.3	$ 9.6	$ 4.4
Canada	.2	.4	—
Latin America	2.3	(.3)	1.1
Europe	.4	(.4)	.6
Mid East, Far East and Africa	1.4	.5	1.7
Equity earnings from continuing operations	14.6	9.8	7.8
Discontinued operations	22.7	26.7	25.6
Total equity earnings	$ 37.3	$ 36.5	$ 33.4
Identifiable assets			
United States	$1,541.1	$1,323.8	$1,608.7
Canada	74.4	120.1	121.3
Latin America	78.9	97.4	121.7
Europe	461.8	557.6	507.8
Mid East, Far East and Africa	144.6	119.6	155.8
Adjustments and eliminations	(128.0)	(163.5)	(197.0)
Total identifiable assets	$2,172.8	$2,055.0	$2,318.3
United States export sales			
Canada	$ 34.9	$ 30.0	$ 25.1
Latin America	111.8	101.0	130.4
Europe	50.7	49.8	73.5
Mid East, Far East and Africa	204.0	130.9	222.9
Total United States export sales	$ 401.4	$ 311.7	$ 451.9