Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2004

OR

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

Commission File Number 1-9397

Baker Hughes Incorporated

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**76-0207995** (IRS Employer Identification No.)

3900 Essex Lane, Suite 1200, Houston, Texas
(Address of principal executive offices)
77027
(Zip Code)

Registrant's telephone number, including area code: **(713) 439-8600**

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2).

YES [X] NO [ ]

As of October 29, 2004, the registrant has outstanding 335,469,673 shares of Common Stock, $1 par value per share.

INDEX

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

Baker Hughes Incorporated

Consolidated Condensed Statements of Operations
(In millions, except per share amounts)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Revenues	$ 1,538.1	$ 1,328.8	$ 4,424.7	$ 3,824.4
Costs and expenses:				
Cost of revenues	1,103.8	967.8	3,190.1	2,798.6
Selling, general and administrative	229.7	193.9	675.9	595.7
Impairment of investment in affiliate	—	45.3	—	45.3
Restructuring charge reversal	—	(1.1)	—	(1.1)
Total	1,333.5	1,205.9	3,866.0	3,438.5
Operating income	204.6	122.9	558.7	385.9
Equity in income (loss) of affiliates	10.0	(145.9)	22.4	(149.9)
Interest expense	(17.6)	(25.1)	(64.7)	(78.1)
Interest income	0.8	0.6	3.6	3.7
Income (loss) from continuing operations before income taxes	197.8	(47.5)	520.0	161.6
Income taxes	(60.5)	(12.4)	(171.6)	(89.7)
Income (loss) from continuing operations	137.3	(59.9)	348.4	71.9
Income (loss) from discontinued operations, net of tax	0.2	(38.9)	0.6	(39.0)
Income (loss) before cumulative effect of accounting change	137.5	(98.8)	349.0	32.9
Cumulative effect of accounting change, net of tax	—	—	—	(5.6)
Net income (loss)	$ 137.5	$ (98.8)	$ 349.0	$ 27.3
Basic earnings per share:				
Income (loss) from continuing operations	$ 0.41	$ (0.18)	$ 1.05	$ 0.21
Income (loss) from discontinued operations	—	(0.12)	—	(0.12)
Cumulative effect of accounting change	—	—	—	(0.01)
Net income (loss)	$ 0.41	$ (0.30)	$ 1.05	$ 0.08
Diluted earnings per share:				
Income (loss) from continuing operations	$ 0.41	$ (0.18)	$ 1.04	$ 0.21
Income (loss) from discontinued operations	—	(0.11)	—	(0.12)
Cumulative effect of accounting change	—	—	—	(0.01)
Net income (loss)	$ 0.41	$ (0.29)	$ 1.04	$ 0.08
Cash dividends per share	$ 0.115	$ 0.115	$ 0.345	$ 0.345

See accompanying notes to consolidated condensed financial statements.

Baker Hughes Incorporated

Consolidated Condensed Balance Sheets
(In millions)

	September 30, 2004 (Unaudited)	December 31, 2003 (Audited)
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 106.8	$ 98.4
Accounts receivable, net	1,259.0	1,141.8
Inventories	1,045.9	1,013.4
Deferred income taxes	150.2	170.8
Other current assets	37.7	58.1
Assets of discontinued operations	—	48.7
Total current assets	2,599.6	2,531.2
Investments in affiliates	685.2	691.3
Property, net	1,333.2	1,395.1
Goodwill	1,245.1	1,239.4
Intangible assets, net	153.0	163.4
Other assets	291.5	281.8
Total assets	$ 6,307.6	$ 6,302.2
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 420.6	$ 386.4
Short-term borrowings and current portion of long-term debt	24.1	351.4
Accrued employee compensation	301.8	277.8
Other accrued liabilities	307.8	279.3
Liabilities of discontinued operations	—	29.5
Total current liabilities	1,054.3	1,324.4
Long-term debt	1,097.3	1,133.0
Pensions and postretirement benefit obligations	306.4	311.1
Other liabilities	190.0	183.3
Stockholders' equity:		
Common stock	335.1	332.0
Capital in excess of par value	3,075.7	2,998.6
Retained earnings	405.0	170.9
Accumulated other comprehensive loss	(156.2)	(151.1)
Total stockholders' equity	3,659.6	3,350.4
Total liabilities and stockholders' equity	$ 6,307.6	$ 6,302.2

See accompanying notes to consolidated condensed financial statements.

Table of Contents

Baker Hughes Incorporated

Consolidated Condensed Statements of Cash Flows
(In millions)
(Unaudited)

	Nine Months Ended September 30, 2004	Nine Months Ended September 30, 2003
Cash flows from operating activities:		
Income from continuing operations	$ 348.4	$ 71.9
Adjustments to reconcile income from continuing operations to net cash flows from operating activities:		
Depreciation and amortization	276.0	257.0
Amortization of deferred gains on derivatives	(6.2)	(4.1)
Provision (benefit) for deferred income taxes	28.7	(33.3)
Gain on disposal of assets	(32.1)	(24.3)
Impairment of investment in affiliate	—	45.3
Equity in (income) loss of affiliates	(22.4)	149.9
Change in accounts receivable	(111.2)	(52.1)
Change in inventories	(42.1)	(57.8)
Change in accounts payable	34.6	(14.8)
Change in accrued employee compensation and other accrued liabilities	41.8	(21.9)
Change in pensions and postretirement obligations and other liabilities	0.1	(14.2)
Changes in other assets and liabilities	2.5	29.8
Net cash flows from continuing operations	518.1	331.4
Net cash flows from discontinued operations	—	4.9
Net cash flows from operating activities	518.1	336.3
Cash flows from investing activities:		
Expenditures for capital assets	(242.3)	(270.2)
Acquisition of business, net of cash acquired	—	(9.6)
Investments in affiliates	(7.1)	(35.4)
Net proceeds from sale of businesses and interest in affiliate	59.2	22.0
Proceeds from disposal of assets	81.8	44.7
Other	(5.6)	—
Net cash flows from continuing operations	(114.0)	(248.5)
Net cash flows from discontinued operations	(0.4)	(0.8)
Net cash flows from investing activities	(114.4)	(249.3)
Cash flows from financing activities:		
Net borrowings (payments) of commercial paper and other short-term debt	(6.5)	57.6
Repayment of indebtedness	(350.0)	(100.0)
Proceeds from termination of interest rate swap	—	15.5
Proceeds from issuance of common stock	75.2	38.1
Repurchase of common stock	—	(72.9)
Dividends	(114.9)	(115.8)
Net cash flows from financing activities	(396.2)	(177.5)
Effect of foreign exchange rate changes on cash	0.9	(2.0)
Increase (decrease) in cash and cash equivalents	8.4	(92.5)
Cash and cash equivalents, beginning of period	98.4	143.9
Cash and cash equivalents, end of period	$ 106.8	$ 51.4
Income taxes paid	$ 105.4	$ 151.4
Interest paid	$ 87.5	$ 92.7

See accompanying notes to consolidated condensed financial statements.

Baker Hughes Incorporated

Notes to Consolidated Condensed Financial Statements

NOTE 1. GENERAL

Nature of Operations

Baker Hughes Incorporated ("we," "our" or "us") is engaged in the oilfield services industry. We are a major supplier of wellbore related products and technology services and systems to the oil and natural gas industry on a worldwide basis and provide products and services for drilling, formation evaluation, completion and production of oil and natural gas wells.

Basis of Presentation

Our unaudited consolidated condensed financial statements included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. We believe that the presentations and disclosures herein are adequate to make the information not misleading. The unaudited consolidated condensed financial statements reflect all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the interim periods. These unaudited consolidated condensed financial statements should be read in conjunction with our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2003. The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the full year.

In the notes to the unaudited consolidated condensed financial statements, all dollar and share amounts in tabulations are in millions of dollars and shares, respectively, unless otherwise indicated.

Certain reclassifications, including reclassifications for deferred income taxes and other tax liabilities, have been made to the prior year's consolidated condensed financial statements to conform with the current period presentation.

NOTE 2. STOCK-BASED COMPENSATION

As allowed under Statement of Financial Accounting Standards ("SFAS") No. 123, *Accounting for Stock-Based Compensation*, we have elected to account for our stock-based compensation using the intrinsic value method of accounting in accordance with Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*. Under this method, no compensation expense is recognized when the number of shares granted is known and the exercise price of the stock option at the time of grant is equal to or greater than the market price of our common stock. Reported net income does not include any compensation expense associated with stock options but does include compensation expense associated with restricted stock awards.

If we had recognized compensation expense as if the fair value based method had been applied to all awards as provided for under SFAS No. 123, our pro forma net income (loss), earnings per share ("EPS") and stock-based compensation cost would have been as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	**2003**	**2004**	**2003**
Net income (loss), as reported	$ 137.5	$ (98.8)	$ 349.0	$ 27.3
Add: Stock-based compensation for restricted stock awards included in reported net income (loss), net of tax	0.7	0.4	1.1	1.7
Deduct: Stock-based compensation determined under the fair value method, net of tax	(5.5)	(6.4)	(15.5)	(18.7)
Pro forma net income (loss)	$ 132.7	$ (104.8)	$ 334.6	$ 10.3
Basic EPS				
As reported	$ 0.41	$ (0.30)	$ 1.05	$ 0.08
Pro forma	0.40	(0.31)	1.00	0.03
Diluted EPS				
As reported	$ 0.41	$ (0.29)	$ 1.04	$ 0.08
Pro forma	0.39	(0.31)	1.00	0.03

These pro forma calculations may not be indicative of future amounts since additional awards in future years are anticipated.

Baker Hughes Incorporated
Notes to Consolidated Condensed Financial Statements (continued)

NOTE 3. DISCONTINUED OPERATIONS

In September 2004, we completed the sale of Baker Hughes Mining Tools ("BHMT"), a product line group within our Hughes Christensen division that manufactured rotary drill bits used in the mining industry. We received proceeds of $32.0 million, which are subject to post-closing adjustments to the purchase price. In the three months ended September 30, 2004, we recorded a gain on sale of $0.5 million, net of tax of $3.8 million, which consisted of a gain on disposal of $7.1 million offset by a loss of $6.6 million related to the recognition of the cumulative foreign currency translation adjustments into earnings.

In January 2004, we completed the sale of BIRD Machine ("BIRD"), the remaining division of the former Process segment, and recorded an additional loss on sale of $0.5 million with no tax benefit. We received $5.6 million in proceeds in January 2004, which were subject to post-closing adjustments to the purchase price, and retained certain accounts receivable, inventories and other assets. During the second quarter of 2004, we made a net payment of $6.8 million to the buyer in settlement of the final purchase price adjustments. The adjustments were the result of changes in the value of assets sold to and liabilities assumed by the buyer during the time frame in which the initial sales price was negotiated and the date of the closing of the sale.

In January 2003, we sold our interest in oil producing operations in West Africa and recorded a gain on sale of $4.1 million, net of a tax benefit of $0.2 million. In the first quarter of 2003, we also recorded an additional loss on the sale of EIMCO Process Equipment ("EIMCO"), which was sold in November 2002, due to purchase price adjustments of $2.5 million, net of tax of $1.3 million.

We have reclassified our consolidated condensed financial statements for all prior periods presented to reflect these operations as discontinued.

Summarized financial information from discontinued operations is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Revenues:				
BHMT	$ 8.0	$ 9.7	$ 29.4	$ 29.0
BIRD	—	21.1	1.6	74.2
Oil producing operations	—	—	—	4.2
Total	$ 8.0	$ 30.8	$ 31.0	$ 107.4
Income (loss) before income taxes:				
BHMT	$ (0.7)	$ 0.5	$ 0.9	$ 2.5
BIRD	0.1	(5.9)	(0.2)	(12.1)
Oil producing operations	—	—	—	1.8
Total	(0.6)	(5.4)	0.7	(7.8)
Income taxes:				
BHMT	0.3	(0.1)	(0.2)	(0.9)
BIRD	—	2.1	0.1	4.3
Oil producing operations	—	—	—	(0.7)
Total	0.3	2.0	(0.1)	2.7
Income (loss) before gain (loss) on disposal:				
BHMT	(0.4)	0.4	0.7	1.6
BIRD	0.1	(3.8)	(0.1)	(7.8)
Oil producing operations	—	—	—	1.1
Total	(0.3)	(3.4)	0.6	(5.1)
Gain (loss) on disposal:				
BHMT	0.5	—	0.5	—
BIRD	—	(35.5)	(0.5)	(35.5)
Oil producing operations	—	—	—	4.1
EIMCO	—	—	—	(2.5)
Total	0.5	(35.5)	—	(33.9)
Income (loss) from discontinued operations	$ 0.2	$ (38.9)	$ 0.6	$ (39.0)

Baker Hughes Incorporated
Notes to Consolidated Condensed Financial Statements (continued)

Assets and liabilities of discontinued operations at December 31, 2003 are as follows:

	December 31, 2003
Accounts receivable, net	$ 13.4
Inventories	21.4
Other current assets	0.9
Property, net	13.0
Assets of discontinued operations	$ 48.7
Accounts payable	$ 13.2
Accrued employee compensation	6.6
Other accrued liabilities	8.0
Other liabilities	1.7
Liabilities of discontinued operations	$ 29.5

NOTE 4. ACQUISITION

In the second quarter of 2003, we made an acquisition with an aggregate purchase price of $12.7 million, of which $9.6 million was paid in cash. As a result of this acquisition, we recorded approximately $9.8 million of intangible assets through September 30, 2003. The purchase price is allocated based on fair value of the acquisition. Pro forma results of operations have not been presented because the effect of this acquisition was not material to our consolidated condensed financial statements.

NOTE 5. COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) includes all changes in equity during a period except those resulting from investments by and distributions to owners. The components of our comprehensive income (loss), net of related tax, are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Net income (loss)	$ 137.5	$ (98.8)	$ 349.0	$ 27.3
Other comprehensive income (loss):				
Foreign currency translation adjustments:				
Translation adjustments during the period	10.4	(2.4)	(9.9)	49.4
Reclassifications included in net income (loss) due to sale of BHMT and BIRD	6.6	18.2	6.6	18.2
Net loss on derivative instruments	(1.1)	—	(1.0)	—
Unearned compensation	0.5	—	(0.8)	—
Total comprehensive income (loss)	$ 153.9	$ (83.0)	$ 343.9	$ 94.9

Total accumulated other comprehensive loss consisted of the following:

	September 30, 2004	December 31, 2003
Foreign currency translation adjustments	$ (93.1)	$ (89.8)
Pension adjustment	(61.3)	(61.3)
Net loss on derivative instruments	(1.0)	—
Unearned compensation	(0.8)	—
Total accumulated other comprehensive loss	$ (156.2)	$ (151.1)

Baker Hughes Incorporated
Notes to Consolidated Condensed Financial Statements (continued)

NOTE 6. EARNINGS PER SHARE

A reconciliation of the number of shares used for the basic and diluted EPS calculation is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Weighted average common shares outstanding for basic EPS	334.1	334.7	333.2	335.6
Effect of dilutive securities – stock plans	1.8	1.3	1.7	1.1
Adjusted weighted average common shares outstanding for diluted EPS	335.9	336.0	334.9	336.7
Future potentially dilutive shares excluded from diluted EPS:				
Options with an exercise price greater than average market price for the period	3.5	6.9	5.1	6.9

NOTE 7. INVENTORIES

Inventories are comprised of the following:

	September 30, 2004	December 31, 2003
Finished goods	$ 855.6	$ 846.2
Work in process	116.7	98.1
Raw materials	73.6	69.1
Total	$ 1,045.9	$ 1,013.4

NOTE 8. INVESTMENTS IN AFFILIATES

We have investments in affiliates that are accounted for using the equity method of accounting. The most significant of these affiliates is WesternGeco, a seismic venture in which we own 30% and Schlumberger Limited ("Schlumberger") owns 70%. Summarized unaudited operating results for WesternGeco are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Revenues	$ 300.6	$ 262.8	$ 905.3	$ 875.4
Operating income (loss)	31.5	(488.3)	78.4	(505.8)
Net income (loss)	29.1	(493.8)	64.9	(525.8)

The summarized unaudited financial position of WesternGeco is as follows:

	September 30, 2004	December 31, 2003
Current assets	$ 682.6	$ 606.4
Noncurrent assets	1,168.2	1,302.5
Total assets	$ 1,850.8	$ 1,908.9
Current liabilities	$ 454.5	$ 508.1
Noncurrent liabilities	101.9	171.5
Stockholders' equity	1,294.4	1,229.3
Total liabilities and stockholders' equity	$ 1,850.8	$ 1,908.9

In February 2004, we completed the sale of our minority interest in Petreco International for $35.8 million. We received $28.4 million in cash, with the remaining $7.4 million held in escrow pending the outcome of potential indemnification obligations pursuant to the sales agreement. We recognized a gain of $1.3 million, net of tax of $1.5 million.

Baker Hughes Incorporated
Notes to Consolidated Condensed Financial Statements (continued)

Included in the caption "Equity in income (loss) of affiliates" for the three months and nine months ended September 30, 2003 is $135.7 million for our share of the $452.0 million of certain impairment and restructuring charges taken by WesternGeco. The charges related to the impairment of WesternGeco's multiclient seismic library and rationalization of WesternGeco's marine seismic fleet. In addition, as a result of the continuing weakness in the seismic industry, we evaluated the value of our investment in WesternGeco and recorded an impairment loss of $45.3 million in the third quarter of 2003 to write-down the investment to its fair value. The fair value was determined using a combination of a market capitalization and discounted cash flows approach. We were assisted in the determination of the fair value by an independent third party.

In connection with the formation of WesternGeco in November 2000, we entered into an agreement with Schlumberger whereby a cash true-up payment will be made by either of the parties based on a formula comparing the ratio of the net present value of sales revenue from each party's contributed multiclient seismic libraries during the four-year period ending November 30, 2004 and the ratio of the net book value of those libraries as of November 30, 2000. The maximum payment that either party will be required to make as a result of this adjustment is $100.0 million. In the event that future sales from the contributed libraries continue through November 30, 2004 in the same relative percentages incurred through June 30, 2004, we currently estimate that Schlumberger will make a payment to us in the range of $8.0 million to $10.0 million. We expect that the payment will be made in the first quarter of 2005. Any payment received by us will be recorded as an adjustment to the carrying value of our investment in WesternGeco.

During the nine months ended September 30, 2003, we invested cash of $35.4 million in affiliates, of which $30.1 million related to our 50% interest in the QuantX Wellbore Instrumentation venture ("QuantX") with Expro International ("Expro"). The venture is engaged in the permanent in-well monitoring market and was formed in the second quarter of 2003 by combining Expro's existing permanent monitoring business with one of our product lines. We account for our ownership in QuantX using the equity method of accounting.

NOTE 9. GOODWILL AND INTANGIBLE ASSETS

The changes in the carrying amount of goodwill (net of accumulated amortization) for the nine months ended September 30, 2004 are as follows:

Balance as of December 31, 2003	$1,239.4
Additional consideration for previous acquisition	5.6
Translation adjustments and other	0.1
Balance as of September 30, 2004	$1,245.1

Intangible assets which are being amortized are comprised of the following:

	September 30, 2004			December 31, 2003		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Technology based	$ 183.7	$ (55.4)	$ 128.3	$ 183.5	$ (46.8)	$ 136.7
Marketing related	21.9	(5.4)	16.5	21.9	(5.0)	16.9
Contract based	10.8	(3.9)	6.9	11.2	(2.9)	8.3
Customer based	0.6	(0.2)	0.4	0.6	(0.1)	0.5
Other	2.0	(1.1)	0.9	2.0	(1.0)	1.0
Total	$ 219.0	$ (66.0)	$ 153.0	$ 219.2	$ (55.8)	$ 163.4

Amortization expense for intangible assets for the three months and nine months ended September 30, 2004 was $3.5 million and $10.3 million, respectively, and is estimated to be $13.7 million for 2004. Estimated amortization expense for each of the subsequent five fiscal years is expected to be within the range of $12.1 million to $15.9 million.

Baker Hughes Incorporated
Notes to Consolidated Condensed Financial Statements (continued)

NOTE 10. FINANCIAL INSTRUMENTS

In April 2004, we entered into an interest rate swap agreement for a notional amount of $325.0 million associated with our 6.25% Notes due January 2009. Under this agreement we receive interest at a fixed rate of 6.25% and pay interest at a floating rate of six-month LIBOR plus a spread of 2.741%. The interest rate swap agreement has been designated and qualifies as a fair value hedging instrument. The interest rate swap agreement is fully effective, resulting in no gain or loss recorded in the consolidated condensed statement of operations. We recorded the fair value of the interest rate swap agreement, which was a $1.8 million liability at September 30, 2004 based on quoted market prices for contracts with similar terms and maturity dates.

At September 30, 2004, we had entered into several foreign currency forward contracts with notional amounts aggregating $86.0 million to hedge exposure to currency fluctuations in various foreign currencies, including the British Pound Sterling, the Euro, the Norwegian Krone, the Brazilian Real, and the Indonesian Rupiah. These contracts are designated and qualify as fair value hedging instruments. Based on quoted market prices as of September 30, 2004 for contracts with similar terms and maturity dates, we recorded a gain of $0.7 million to adjust these foreign currency forward contracts to their fair market value. This gain offsets designated foreign exchange losses resulting from the underlying exposures and is included in selling, general and administrative expense in the consolidated condensed statement of operations.

At September 30, 2004, we had entered into several foreign currency forward contracts with notional amounts aggregating $55.5 million to hedge exposure to currency fluctuations in the British Pound Sterling and the Canadian Dollar. These exposures arise when local currency operating expenses are not in balance with local currency revenue collections. The funding of such imbalances is supported by short-term intercompany borrowing commitments that have definitive amounts and funding dates. All fundings are scheduled to take place on or before December 31, 2004. These foreign currency forward contracts were designated as cash flow hedging instruments and are fully effective. Based on quoted market prices as of September 30, 2004 for contracts with similar terms and maturity dates, we recorded a loss of $1.0 million, net of tax of $0.6 million, to adjust these foreign currency forward contracts to their fair market value. This loss is recorded in other comprehensive income in the consolidated condensed balance sheet.

NOTE 11. SEGMENT AND RELATED INFORMATION

We operate through seven divisions — Baker Atlas, Baker Hughes Drilling Fluids, Baker Oil Tools, Baker Petrolite, Centrilift, Hughes Christensen and INTEQ — that have been aggregated into the Oilfield segment because they have similar economic characteristics and because the long-term financial performance of these divisions is affected by similar economic conditions. The consolidated results are evaluated regularly by our chief operating decision maker in deciding how to allocate resources and in assessing performance.

These operating divisions manufacture and sell products and provide services used in the oil and natural gas exploration industry, including drilling, formation evaluation, completion and production of oil and natural gas wells. They also operate in the same markets and have substantially the same customers. The principal markets include all major oil and natural gas producing regions of the world, including North America, South America, Europe, Africa, the Middle East and the Far East. Customers include major multi-national, independent and state-owned oil companies. The Oilfield segment also includes our 30% interest in WesternGeco and other similar businesses.

We evaluate the performance of the Oilfield segment based on its segment profit (loss), which is defined as income (loss) from continuing operations before income taxes, accounting changes, restructuring charges and reversals, impairment of assets and interest income and expense.

Baker Hughes Incorporated
Notes to Consolidated Condensed Financial Statements (continued)

Summarized financial information is shown in the following table. The "Corporate and Other" column includes corporate-related items, results of insignificant operations and, as it relates to segment profit (loss), income and expense not allocated to the Oilfield segment, including restructuring charges and reversals and impairment of assets. The "Corporate and Other" column at December 31, 2003 also includes assets of discontinued operations.

	Oilfield	Corporate and Other	Total
Revenues			
Three months ended September 30, 2004	$ 1,537.1	$ 1.0	$ 1,538.1
Three months ended September 30, 2003	1,328.8	—	1,328.8
Nine months ended September 30, 2004	4,422.3	2.4	4,424.7
Nine months ended September 30, 2003	3,824.4	—	3,824.4
Segment profit (loss)			
Three months ended September 30, 2004	$ 268.1	$ (70.3)	$ 197.8
Three months ended September 30, 2003	193.3	(240.8)	(47.5)
Nine months ended September 30, 2004	732.4	(212.4)	520.0
Nine months ended September 30, 2003	524.3	(362.7)	161.6
Total assets			
As of September 30, 2004	$ 5,929.0	$ 378.6	$ 6,307.6
As of December 31, 2003	5,777.2	525.0	6,302.2

The following table presents the details of "Corporate and Other" segment loss:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Corporate expenses	$ (53.5)	$ (36.4)	$ (151.3)	$ (108.4)
Interest, net	(16.8)	(24.5)	(61.1)	(74.4)
Restructuring charge reversal	—	1.1	—	1.1
Impairment of investment in affiliate	—	(45.3)	—	(45.3)
Impairment and restructuring charge related to an equity method investment	—	(135.7)	—	(135.7)
Total	$ (70.3)	$ (240.8)	$ (212.4)	$ (362.7)

NOTE 12. EMPLOYEE BENEFIT PLANS

Defined Benefit Pension Plans

We have noncontributory defined benefit pension plans ("Pension Benefits") covering various domestic and foreign employees. The components of net periodic benefit cost are as follows:

	U.S. Pension Benefits			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Service cost	$ 5.1	$ 4.2	$ 15.4	$ 12.5
Interest cost	2.7	2.3	8.0	6.8
Expected return on plan assets	(5.1)	(3.8)	(15.3)	(11.2)
Recognized actuarial loss	1.0	1.6	3.0	4.8
Net periodic benefit cost	$ 3.7	$ 4.3	$ 11.1	$ 12.9

	Non U.S. Pension Benefits			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Service cost	$ 0.5	$ 1.4	$ 1.4	$ 4.1
Interest cost	3.4	3.0	10.1	9.0
Expected return on plan assets	(2.3)	(2.0)	(6.8)	(6.0)
Recognized actuarial loss	1.2	0.7	3.5	2.1
Net periodic benefit cost	$ 2.8	$ 3.1	$ 8.2	$ 9.2

Postretirement Welfare Benefits

We provide certain postretirement health care and life insurance benefits to substantially all U.S. employees who retire and have met certain age and service requirements. The components of net periodic benefit cost are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Service cost	$ 1.3	$ 1.2	$ 4.1	$ 3.6
Interest cost	2.4	2.6	7.3	7.8
Amortization of prior service cost	0.1	0.2	0.5	0.4
Recognized actuarial loss	0.2	0.2	0.8	0.8
Net periodic benefit cost	$ 4.0	$ 4.2	$ 12.7	$ 12.6

In May 2004, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position No. FAS 106-2 ("FSP 106-2"), *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003*, which provides guidance on the accounting for the effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 for employers that sponsor postretirement health care plans that provide prescription drug benefits. We adopted the provisions of FSP 106-2 in the third quarter of 2004, resulting in a reduction in our accumulated postretirement benefit obligation of $18.8 million. We recognized a reduction in our net periodic postretirement benefit costs of $0.7 million and $1.3 million for the three months and nine months ended September 30, 2004, respectively, as a result of the adoption of FSP 106-2. Results for the three months ended June 30, 2004 have been restated to reflect the retroactive application of FSP 106-2. The impact for the three months ended June 30, 2004 was an increase in income from continuing operations of $0.4 million, net of tax of $0.2 million. There was no impact on any other prior period.

NOTE 13. GUARANTEES

In the normal course of business with customers, vendors and others, we are contingently liable for performance under letters of credit and other bank issued guarantees, which totaled approximately $302.2 million at September 30, 2004. We have also guaranteed debt and other obligations of third parties totaling up to $7.9 million at September 30, 2004.

We sell certain of our products to customers with a product warranty that provides that customers can return a defective product during a specified warranty period following the purchase in exchange for a replacement product, repair at no cost to the customer or the issuance of a credit to the customer. We accrue amounts for estimated warranty claims based upon both current and historical product sales data, warranty costs incurred and any other related information known to us.

The changes in the aggregate product warranty liabilities for the nine months ended September 30, 2004 are as follows:

Balance as of December 31, 2003	$ 14.1
Claims paid	(3.2)
Additional warranties issued	2.4
Balance as of September 30, 2004	$ 13.3

NOTE 14. NEW ACCOUNTING STANDARDS

In January 2003, the FASB issued FASB Interpretation No. 46 (“FIN 46”), *Consolidation of Variable Interest Entities*. An entity is subject to the consolidation rules of FIN 46 and is referred to as a variable interest entity (“VIE”) if the entity’s equity investors lack the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its operations without additional financial support. In December 2003, the FASB issued modifications to FIN 46 (“FIN 46R”), resulting in multiple effective dates based on the nature as well as the creation date of a VIE. The adoption of FIN 46 and FIN 46R in 2004 had no impact on our consolidated condensed financial statements.

NOTE 15. CONTINGENCY

On May 10, 2004, the District Court of Andrews County, Texas entered a judgment in favor of LOTUS, LLC and against INTEQ in the amount of $14.8 million for lost profits resulting from a breach of contract in drilling a well to create a salt cavern for disposing of naturally occurring radioactive waste. We have filed an appeal and, while we believe we have a valid basis for appeal and intend to vigorously pursue it, our appeal could be denied and the judgment affirmed against INTEQ.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with our consolidated condensed financial statements and the related notes thereto, as well as our Annual Report on Form 10-K for the year ended December 31, 2003.

EXECUTIVE SUMMARY

We are engaged in the oilfield services industry and operate through seven divisions — Baker Atlas, Baker Hughes Drilling Fluids, Baker Oil Tools, Baker Petrolite, Centrilift, Hughes Christensen and INTEQ — that we aggregate and refer to as the Oilfield segment. We manufacture and sell products and provide services used in the oil and natural gas industry, including drilling, formation evaluation, completion and production of oil and natural gas wells. We have operations in over 80 countries around the world, with headquarters in Houston, Texas.

Our products and services are sold in highly competitive markets, and our revenues and earnings can be affected by changes in competitive prices, fluctuations in the level of activity in major markets, general economic conditions, foreign exchange fluctuations and governmental regulation. We compete with the oil and natural gas industry's largest diversified oilfield service providers, as well as many small companies. We believe that the principal competitive factors in our industry are product and service quality; availability and reliability; health, safety and environmental standards; technical proficiency and price. We consider our key business drivers to include the rig count, oil and natural gas production levels and current and expected future energy prices.

In the third quarter of 2004, we reported revenues of $1,538.1 million, a 15.8% increase compared with the third quarter of 2003. The increase in revenues was primarily a result of increased activity from land rigs drilling for natural gas in the U.S., driven by continued investment in drilling for natural gas prospects, and increased activity in certain international markets including Latin America, Russia, the Caspian region, Africa and Asia. These increases were partially offset by lower activity in the Gulf of Mexico due to hurricanes and in Norway due to the offshore oil workers strike. Income from continuing operations for the third quarter of 2004 was $137.3 million compared with a loss from continuing operations of $59.9 million for the third quarter of 2003. Included in the loss from continuing operations for the third quarter of 2003 are charges, net of tax, of $105.9 million related to our share of the WesternGeco restructuring charge and $45.3 million related to the impairment of our investment in WesternGeco.

BUSINESS ENVIRONMENT

Our business environment and its corresponding operating results are significantly affected by the level of energy industry spending for the exploration for and production of ("E&P") oil and natural gas reserves. An indicator for this spending is the rig count because when drilling and workover rigs are active, many of the products and services provided by the oilfield services industry are required. Our products and services are used during the drilling and workover phases, during the completion of the oil and natural gas wells and during actual production of the hydrocarbons. This spending by oil and natural gas companies is in turn influenced strongly by expectations about the supply and demand for oil and natural gas products and by current and expected prices for both oil and natural gas. Rig counts therefore generally reflect the relative strength and stability of energy prices.

Rig Counts

We have been providing rig counts to the public since 1944. We gather all relevant data through our field service personnel, who obtain the necessary data from routine visits to the various rigs, customers, contractors or other outside sources. This data is then compiled and distributed to various wire services and trade associations and is published on our website. Rig counts are compiled weekly for the U.S. and Canada and monthly for all international rigs and U.S. workover rigs. Published international rig counts do not include rigs drilling in certain countries, such as Russia and onshore China, because this information is extremely difficult to obtain.

North American rigs are counted as active if, on the day the count is taken, the well being drilled has been started, drilling has not been completed and the well is anticipated to be of sufficient depth to be a potential consumer of our drill bits. In most international areas, rigs are counted as active if drilling operations have taken place for at least 15 days during the month and if the well has not reached the target depth. The rig count does not include rigs that are in transit from one location to another, are rigging up, have been drilling less than 15 days of the month, are being used in non-drilling activities including production testing, completion and workover, or are not significant consumers of oilfield products and services. In some active international areas where better data is available, a weekly or daily average of active rigs is taken.

Our rig counts are summarized in the table below as averages for each of the periods indicated.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
U.S. — Land	1,133	979	1,075	896
U.S. — Offshore	95	109	96	109
Canada	327	385	346	358
North America	1,555	1,473	1,517	1,363
Latin America	291	253	285	237
North Sea	34	49	40	47
Other Europe	28	39	30	38
Africa	49	50	48	54
Middle East	236	212	227	211
Asia Pacific	208	179	197	177
Outside North America	846	782	827	764
Worldwide	2,401	2,255	2,344	2,127
U.S. Workover Rigs	1,255	1,164	1,215	1,120

The U.S. — land rig count increased 15.7% in the third quarter of 2004 compared with the third quarter of 2003 due to the increase in drilling for natural gas, which accounted for 86.1% of total U.S. drilling activity. The Canadian rig count was down 15.1% in the third quarter of 2004 compared with the third quarter of 2003. Unusually wet weather in Canada in the third quarter of 2004 resulted in fewer active rigs compared with the third quarter of 2003. The U.S. — offshore rig count decreased 12.8% in the third quarter of 2004 compared with the third quarter of 2003.

Outside North America, rig counts increased 8.2% in the third quarter of 2004 compared with the third quarter of 2003. The rig count in Latin America increased 15.0% compared with the third quarter of 2003 driven primarily by spending increases in Mexico, Venezuela and Argentina. The North Sea rig count in the third quarter of 2004 decreased 30.6% compared with the third quarter of 2003 primarily driven by continued declines in drilling activity in the U.K. sector and the impact of an offshore oil workers strike in Norway. Major diversified oil and natural gas companies continue to redirect spending towards other larger international projects, especially in Russia and the Caspian region. Activity in the Middle East continued to rise steadily with an 11.3% increase in the rig count for the third quarter of 2004 compared with the third quarter of 2003. Rig counts in Africa declined 2.0% in the third quarter of 2004 compared with the third quarter of 2003. Rig activity in the Asia Pacific region was up 16.2% in the third quarter of 2004 compared with the third quarter of 2003 primarily due to activity increases in Indonesia, India and Australia.

Oil and Natural Gas Prices

Generally, changes in the current price and expected future prices of oil or natural gas drive both customers' expectations about their prospects from oil and natural gas sales and their expenditures to explore for or produce oil and natural gas. Accordingly, changes in these expenditures will normally result in increased or decreased demand for our products and services. Oil (Bloomberg West Texas Intermediate (WTI) Cushing Crude Oil Spot Price) and natural gas (Bloomberg Henry Hub Natural Gas Spot Price) prices are summarized in the table below as averages of the daily closing prices during each of the periods indicated.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Oil prices ($/Bbl)	$ 43.91	$ 30.21	$ 39.26	$ 31.03
Natural gas prices ($/mmBtu)	5.50	4.88	5.74	5.62

Oil prices averaged $43.91/Bbl in the third quarter of 2004, continuing the increasing trend that began in September/October 2003. Oil prices remained volatile during the third quarter, rising from a low of just under $39/Bbl at the beginning of the quarter to a high of near $50/Bbl at the end of the quarter. Subsequent to the end of the quarter, oil prices have been trading above $50/Bbl. The primary factors influencing oil prices during the third quarter of 2004 included persistent low inventories, strong economic growth in both the U.S. and China, the lack of excess capacity within the Organization of Petroleum Exporting Countries ("OPEC"), hurricanes in the Gulf of Mexico and concerns over the possibility of additional disruptions of Iraqi exports.

During the third quarter of 2004, natural gas prices averaged $5.50/mmBtu. Prices were volatile during the quarter, ranging from $6/mmBtu in early June to a low of $4.40/mmBtu in early September, before rising to $6.45/mmBtu by the end of the quarter. High prices in the beginning of the third quarter discouraged industrial demand and allowed storage operators to build inventories. Prices fell as storage approached three trillion cubic feet and then rose again as hurricanes in the Gulf of Mexico impacted natural gas production.

Key Risk Factors

Our business is focused on providing products and services to the worldwide oil and natural gas industry; therefore, our risk factors are centered on those factors that impact the markets for oil and natural gas. Key risk factors currently influencing the worldwide oil and natural gas markets that could impact our outlook are discussed below.

- *Production control* — the degree to which individual OPEC nations and other large oil and natural gas producing countries, including, but not limited to, Mexico, Norway and Russia, are willing and able to control production and exports of oil, to decrease or increase supply and to support their targeted oil price while meeting their market share objectives. Key measures of production control include actual production levels compared with target or quota production levels, oil price compared with targeted oil price and changes in each country's market share.

- *Global economic growth* — particularly the impact of the U.S. and Western European economies and the economic activity in Japan, China, South Korea and other developing areas of Asia where the correlation between economic growth and energy demand is strong. The strength of the U.S. economy and economic growth in developing countries in Asia, particularly China, will be important in 2004. Key measures include U.S. and international economic output, global energy demand and forecasts of future demand by governments and private organizations.

- *Oil and natural gas storage inventory levels* — a measure of the balance between supply and demand. A key measure of U.S. natural gas inventories is the storage level reported weekly by the U.S. Department of Energy compared with historic levels. Key measures for oil inventories include U.S. inventory levels reported by the U.S. Department of Energy and American Petroleum Institute and worldwide estimates reported by the International Energy Agency.

- *Ability to produce natural gas* - the amount of natural gas that can be produced is a function of the number and productivity of new wells drilled, completed and connected to pipelines as well as the rate of production and resulting depletion of existing wells. Advanced technologies, such as horizontal drilling, improve total recovery but also result in a more rapid production decline. Key measures include government and private surveys of natural gas production, company reported production, estimates of reservoir depletion rates and drilling and completion activity.

- *Technological progress* — the design and application of new products that allow oil and natural gas companies to drill fewer wells and to drill, complete and produce wells faster, recover more hydrocarbons and/or lower costs. Key measures also include the overall level of research and engineering spending by oilfield services companies and the pace at which new technology is both introduced commercially and accepted by customers.

- *Maturity of the resource base* — the growing necessity for increased levels of investment and activity to support production from an area the longer it is developed. Key measures include changes in undeveloped hydrocarbon reserves in mature areas like the North Sea, the U.S., Canada and Latin America.

- *Pace of new investment* — the amount oil and natural gas companies choose to invest in emerging markets and any impact it has on their spending in areas where they already have an established presence.

- *Access to capital* - the ability of oil and natural gas companies to access the funds necessary to carry out their E&P plans. Access to capital is particularly important for smaller independent oil and natural gas companies. Key measures of access to capital include cash flow, interest rates, analysis of oil and natural gas company leverage and equity offering activity.

- *Energy prices and price volatility* — the impact of widely fluctuating commodity prices on the stability of the market and subsequent impact on customer spending. While current energy prices are important contributors to positive cash flow at E&P companies, expectations for future prices and price volatility are generally more important for determining future E&P spending. While higher commodity prices generally lead to higher levels of E&P spending, sustained high energy prices can be an impediment to economic growth.

- *Impact of energy prices and price volatility on demand for hydrocarbons* - short-term price changes can result in companies switching to the most economic sources of fuel, prompting a temporary curtailment of demand, while long-term price changes can lead to permanent changes in demand. These changes in demand result in the oilfield services industry being cyclical in nature. Key indicators include hydrocarbon prices on a Btu equivalent basis and indicators of hydrocarbon demand, such as electricity generation or industrial production.

- *Access to prospects* - the ability of oil and natural gas companies to develop economically attractive projects based on their expectations of future energy prices, required investments and resulting returns. Access to prospects may be limited because host governments do not allow access to the reserves or because another oil and natural gas company owns the rights to develop the prospect.

- *Supply disruptions* — the loss of production, the ability to export and/or delay of activity from key oil exporting countries, including, but not limited to, Iraq, Saudi Arabia and other Middle Eastern countries, Nigeria, Norway, Russia and Venezuela, due to political instability, civil unrest, labor issues or military activity. In addition, adverse weather such as hurricanes could impact production facilities, causing supply disruptions.

- *Weather* — the impact of variations in temperatures as compared with normal weather patterns and the related effect on demand for oil and natural gas. A key measure of the impact of weather on energy demand is population-weighted heating and cooling degree days as reported by the U.S. Department of Energy and forecasts of warmer than normal or cooler than normal temperatures. Weather can also impact production, for example, in the North Sea, the Gulf of Mexico and Canada.

- *Government regulations* — the costs incurred by oil and natural gas companies to conform to and comply with government regulations, including environmental regulations, may limit the quantity of oil and natural gas that may be economically produced.

INDUSTRY OUTLOOK

Caution is advised that the factors described in “Forward-Looking Statements” and “Business Environment” could negatively impact our expectation for oil and natural gas demand, oil and natural gas prices and drilling activity.

Oil - Oil prices rose from just below $40/Bbl in early July to over $50/Bbl in early October. Concerns over strong demand and potential supply disruptions prevailed over higher OPEC production rates during the third quarter. Prices approached $50/Bbl in mid-August driven by concerns of export disruptions in Iraq, the Venezuelan recall election and the Yukos bankruptcy in Russia, falling briefly after the peaceful election in Venezuela. Prices rose again in September and early October, exceeding $50/Bbl, as a result of hurricane-related disruptions in the Gulf of Mexico, unrest in Nigeria, and strikes in Norway, Nigeria and Brazil. Oil prices are expected to remain volatile for the balance of the year and into 2005 and to average between $35/Bbl and $55/Bbl. While the balance between supply and demand is expected to remain tight, some forecasters, including the International Energy Agency, have lowered expectations regarding oil demand growth in 2005, reflecting the impact higher prices are expected to have on oil demand and the economy.

Natural Gas — Natural gas prices remained highly volatile during the quarter. Natural gas traded in excess of $6/mmBtu as storage requirements competed with summer demand. As storage filled and oil prices moderated, natural gas prices fell from over $6/mmBtu in early July to $4.40/mmBtu in mid-September. Prices rose again to over $6/mmBtu in early October, primarily as a result of higher oil prices and disruptions of supply caused by hurricanes in the Gulf of Mexico. Natural gas prices are expected to average between $4.50/mmBtu and $6.50/mmBtu for the balance of the year and into 2005. Natural gas drilling activity is expected to remain at current levels or improve modestly over the balance of the year. Oil and natural gas company spending to develop incremental natural gas production has not been sufficient to offset natural decline rates and natural gas markets are expected to remain tightly balanced. Prices are expected to remain volatile with trading at or beyond the extremes of the range possible in response to variations in weather-driven demand or changes in oil prices.

Customer Spending - Based upon our discussions with major customers, review of published industry reports and our outlook for oil and natural gas prices described above, anticipated customer spending trends are as follows:

- North America — Spending in North America, primarily towards developing natural gas supplies, is expected to increase approximately 12% to 14% in 2004 compared with 2003.

- Outside North America — Customer spending, primarily directed at developing oil supplies, is expected to increase 14% to 16% in 2004 compared with 2003.

- Total spending is expected to increase 14% to 16% in 2004 compared with 2003.

Drilling Activity - Based upon our outlook for oil and natural gas prices and customer spending described above, our outlook for drilling activity, as measured by the Baker Hughes rig count, is as follows:

- The North American rig count is expected to increase approximately 10% to 12% in 2004 compared with 2003.

- Drilling activity outside of North America is expected to increase approximately 8% to 10% in 2004 compared with 2003.

COMPANY OUTLOOK

In our outlook for 2004, we took into account the factors described herein. Revenues are expected to increase 14% to 15% in 2004 compared with 2003. Included in this increase for 2004 is approximately $25.0 million of intellectual property license fees that will be recorded in the fourth quarter of 2004 and are not expected to recur in subsequent years. Growth in our revenues should mirror the growth in customer spending. Our assumptions regarding overall growth in customer spending assume strong economic growth in the U.S. and China and OPEC discipline, resulting in an oil price exceeding $40/Bbl. Our assumptions regarding customer spending in North America assume strong economic growth in the U.S. and natural gas prices exceeding $5/mmBtu.

In North America, we expect revenues to increase 12% to 14% in 2004 compared with 2003 primarily due to increased spending on land based projects offset by decreased offshore spending in the Gulf of Mexico.

Outside North America, we expect revenues to increase 15% to 17% in 2004 compared with 2003, continuing the multi-year trend of modest growth in customer spending. Asia Pacific, Latin America, the Caspian region and Russia are expected to demonstrate above average spending increases, resulting in increased revenues, while growth in revenues from Europe, particularly the North Sea, is expected to be below average. Our expectations for spending and revenue growth could decrease if prices fall below $40/Bbl for oil or $5/mmBtu for natural gas or if there are disruptions in key oil and natural gas production markets, such as Venezuela or Nigeria.

In the nine months ended September 30, 2004, WesternGeco contributed $21.9 million of equity income compared with a loss of $9.8 million for all of 2003, which excludes $135.7 million related to our portion of the restructuring and impairment charge taken by WesternGeco in the third quarter of 2003, which we recorded in “Equity in income (loss) of affiliates.” We expect the trend of improving operating results for WesternGeco to continue throughout the remainder of 2004; however, based on the historical trend of operating losses and weakness in the seismic industry in prior years, there is uncertainty regarding the future operating performance of WesternGeco.

Based on the above forecasts, we believe that earnings per share in 2004 from continuing operations will be in the range of $1.48 to $1.51. Significant price increases or significantly better than expected results from WesternGeco could cause earnings per share to reach the upper end of this range. Conversely, significant price decreases or significantly worse than expected results at WesternGeco could result in earnings per share being at or below the lower end of this range. Our ability to improve pricing is dependent on demand for our products and services and our competitors strategies of managing capacity. While the commercial introduction of new technology is an important factor in realizing price improvement, without pricing discipline throughout the industry as a whole, meaningful improvements in our prices are not likely to be realized. Additionally, significant changes in drilling activity outside our expectations could impact operating results positively or negatively.

We do business in approximately 80 countries including about one-half of the 34 countries having the worst scores in Transparency International’s Corruption Perception Index (“CPI”) survey for 2003. We devote significant resources to the development, maintenance and enforcement of our Business Code of Conduct policy, our Foreign Corrupt Practices Act (the “FCPA”) policy, our internal control processes and procedures and other compliance related policies. Notwithstanding the devotion of such resources, and in part as a consequence thereof, from time to time we discover or receive information alleging potential violations of laws and regulations, including the FCPA and our policies, processes and procedures. We conduct internal investigations of these potential violations and take appropriate action depending upon the outcome of the investigation. In addition, U.S. government agencies and authorities are conducting investigations into allegations of potential violations of laws. We anticipate that the devotion of significant resources to compliance related issues, including the necessity for investigations, will continue to be an aspect of doing business in a number of the countries in which oil and natural gas exploration, development and production take place and in which we are requested to conduct operations. Compliance related issues could limit our ability to do business in these countries. In order to provide products and services in some of these countries, we may in the future utilize joint ventures, sell products to distributors or otherwise modify our business approach in order to improve our ability to conduct our business in accordance with laws and regulations and our Business Code of Conduct.

DISCONTINUED OPERATIONS

In September 2004, we completed the sale of Baker Hughes Mining Tools ("BHMT"), a product line group within our Hughes Christensen division that manufactured rotary drill bits used in the mining industry. We received proceeds of $32.0 million, which are subject to post-closing adjustments to the purchase price. In the three months ended September 30, 2004, we recorded a gain on sale of $0.5 million, net of tax of $3.8 million, which consisted of a gain on disposal of $7.1 million offset by a loss of $6.6 million related to the recognition of the cumulative foreign currency translation adjustments into earnings. In January 2004, we completed the sale of BIRD Machine ("BIRD"), the remaining division of the former Process segment, and recorded an additional loss on sale of $0.5 million with no tax benefit. We received $5.6 million in proceeds in January 2004, which were subject to post-closing adjustments to the purchase price, and retained certain accounts receivable, inventories and other assets. During the second quarter of 2004, we made a net payment of $6.8 million to the buyer in settlement of the final purchase price adjustments. The adjustments were the result of changes in the value of assets sold to and liabilities assumed by the buyer during the time frame in which the initial sales price was negotiated and the date of the closing of the sale. In January 2003, we sold our interest in oil producing operations in West Africa and recorded a gain on sale of $4.1 million, net of a tax benefit of $0.2 million. In the first quarter of 2003, we also recorded an additional loss on the sale of EIMCO Process Equipment which was sold in November 2002, due to purchase price adjustments of $2.5 million, net of tax of $1.3 million. We have reclassified our consolidated condensed financial statements for all prior periods presented to reflect these operations as discontinued. See Note 2 of the Notes to Consolidated Condensed Financial Statements for additional information regarding discontinued operations.

RESULTS OF OPERATIONS

The discussions below relating to significant line items are based on available information and represent our analysis of significant changes or events that impact the comparability of reported amounts. Where appropriate, we have identified specific events and changes that affect comparability or trends and, where possible and practical, have quantified the impact of such items.

The table below details certain consolidated condensed statement of operations data and their percentage of revenues for the three months and nine months ended September 30, 2004 and 2003, respectively.

	Three Months Ended September 30,			
	2004		2003	
Revenues	$ 1,538.1	100.0%	$ 1,328.8	100.0%
Cost of revenues	1,103.8	71.8	967.8	72.8
Selling, general and administrative	229.7	14.9	193.9	14.6

	Nine Months Ended September 30,			
	2004		2003	
Revenues	$ 4,424.7	100.0%	$ 3,824.4	100.0%
Cost of revenues	3,190.1	72.1	2,798.6	73.2
Selling, general and administrative	675.9	15.3	595.7	15.6

Revenues

Revenues for the three months ended September 30, 2004 increased 15.8% compared with the three months ended September 30, 2003, reflecting a 6.6% increase in worldwide rig counts. Revenues in North America, which accounted for 40.7% of total revenues, increased 12.3% for the three months ended September 30, 2004 compared with the three months ended September 30, 2003. This increase reflects increased activity in U.S. land operations, as evidenced by a 15.7% increase in the U.S. — land rig count, partially offset by weaker revenues in Canada due to unusually wet weather and the impact of hurricanes in the Gulf of Mexico. Revenues outside North America, which accounted for 59.3% of total revenues, increased 18.2% for the three months ended September 30, 2004 compared with the three months ended September 30, 2003. This increase reflects an 8.2% increase in rig counts outside North America, particularly in Latin America, the Middle East and Asia Pacific, coupled with limited pricing improvement in certain markets and product lines and significant revenue improvements in China and Russia.

Revenues for the nine months ended September 30, 2004 increased 15.7% compared with the nine months ended September 30, 2003. Revenues were positively impacted by the increased activity from land rigs drilling for natural gas in the U.S. and Canada, driven by continued investment in drilling for natural gas prospects, and increased activity in certain international markets including the Caspian region, Russia and China. These increases were partially offset by declines in the Gulf of Mexico due to hurricanes and in Norway due to the offshore oil workers strike.

Cost of Revenues

Cost of revenues for the three months ended September 30, 2004 increased 14.1% compared with the three months ended September 30, 2003. Cost of revenues for the nine months ended September 30, 2004 increased 14.0% compared with the nine months ended September 30, 2003. Cost of revenues as a percentage of consolidated revenues was 71.8% and 72.8% for the three months ended September 30, 2004 and 2003, respectively. Cost of revenues as a percentage of consolidated revenues was 72.1% and 73.2% for the nine months ended September 30, 2004 and 2003, respectively. The decreases are primarily the result of limited pricing improvement in certain markets and product lines, a change in the geographic and product mix from the sale of our products and services and improved cost control measures, including lower repairs and maintenance costs at INTEQ, partially offset by increased material costs.

Selling, General and Administrative

Selling, general and administrative expenses for the three months ended September 30, 2004 increased 18.5% compared with the three months ended September 30, 2003. SG&A expenses for the nine months ended September 30, 2004 increased 13.5% compared with the nine months ended September 30, 2003. These increases are primarily due to higher marketing and administrative expenses as a result of increased activity, including higher annual employee bonus expense, and increased costs related to our continued focus on compliance, including our Sarbanes-Oxley implementation, legal investigations and increased staffing in our legal, compliance and audit groups.

Impairment of Investment in Affiliate

In 2003, as a result of the continuing weakness in the seismic industry, we evaluated the carrying value of our investment in WesternGeco and recorded an impairment loss of $45.3 million in the third quarter of 2003 to write-down the investment to its fair value. The fair value was determined using a combination of a market capitalization and discounted cash flows approach. We were assisted in the determination of the fair value by an independent third party.

Equity in Income (Loss) of Affiliates

Equity in income of affiliates was $10.0 million for the three months ended September 30, 2004 compared with equity in loss of affiliates of $14.2 million in the three months ended September 30, 2003, which excludes $135.7 million related to our portion of the restructuring and impairment charge taken by Western Geco in the third quarter of 2003. During 2003, the operating results of WesternGeco continued to be adversely affected by the continuing weakness in the seismic market and, as a result of this weakness, WesternGeco recorded certain impairment and restructuring charges of $452.0 million for impairment of its multiclient seismic library and rationalization of its marine seismic fleet.

Interest Expense

Interest expense for the three months ended September 30, 2004 decreased $7.5 million compared with the three months ended September 30, 2003 primarily due to lower total debt levels and the effect of the interest rate swap agreement entered into in April 2004. The lower total debt levels are the result of the repayment of $350.0 million of long-term debt in the second quarter of 2004.

Interest expense for the nine months ended September 30, 2004 decreased $13.4 million compared with the nine months ended September 30, 2003 primarily due to lower total debt levels and the effect of the interest rate swap agreement entered into in April 2004. The lower total debt levels are the result of the repayment of $350.0 million of long-term debt in the second quarter of 2004 and the repayment of $100.0 million of long-term debt in the first quarter of 2003.

Income Taxes

Our effective tax rates differ from the statutory income tax rate of 35% due to state income taxes, differing rates of tax on international operations and higher taxes within the WesternGeco venture due to: (i) the venture being taxed in certain foreign jurisdictions based on a deemed profit basis, which is a percentage of revenues rather than profits and (ii) unbenefitted foreign losses of the venture, which are operating losses in certain foreign jurisdictions where there was no current tax benefit and where a deferred tax asset was not recorded due to the uncertainty of its realization. Results for the third quarter of 2004 include the favorable impact from a reduction in our tax rate on operating profit from 34.5% to 33.0% for the year ending December 31, 2004. This reduction was primarily a result of a change from our original estimate in the geographic mix of our pretax profits and the increased international activity. The impact of the reduction was a decrease in income taxes of $7.8 million.

Cumulative Effect of Accounting Change

On January 1, 2003, we adopted Statement of Financial Accounting Standards (“SFAS”) No. 143, *Accounting for Asset Retirement Obligations*. SFAS No. 143 addresses financial accounting and reporting for obligations associated with the retirement of long-lived assets. SFAS No. 143 requires that the fair value of a liability associated with an asset retirement obligation (“ARO”) be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The liability for the ARO is revised each subsequent period due to the passage of time and changes in estimates. The associated retirement costs are capitalized as part of the carrying amount of the long-lived asset and subsequently depreciated over the estimated useful life of the asset.

The adoption of SFAS No. 143 in the first quarter of 2003 resulted in a charge of $5.6 million, net of tax of $2.8 million, recorded as the cumulative effect of accounting change in the consolidated condensed statement of operations. In conjunction with the adoption, we recorded ARO liabilities of $11.4 million primarily for anticipated costs of obligations associated with the future disposal of power source units at certain of our divisions and refurbishment costs associated with certain leased facilities in Europe and with a fleet of leased railcars and tanks.

LIQUIDITY AND CAPITAL RESOURCES

Our objective in financing our business is to maintain adequate financial resources and access to additional liquidity. During the nine months ended September 30, 2004, cash flows from operations and short-term borrowings were the principal sources of funding. We anticipate that this trend will continue throughout the remainder of 2004. We also have a $500.0 million committed revolving credit facility that provides back-up liquidity in the event of an unanticipated significant demand on cash flow that could not be funded by operations or short-term borrowings. This facility expires in July 2006.

Our capital planning process is focused on utilizing cash flows generated from operations in ways that enhance the value of our company. During the nine months ended September 30, 2004, we used cash for a variety of activities including working capital needs, payment of dividends, repayments of indebtedness and capital expenditures. We expect this trend to continue throughout 2004. We do not anticipate any additional material demands, commitments or other events that would require significant outlays of cash.

Cash Flows

Cash flows provided (used) by continuing operations by type of activity were as follows for the nine months ended September 30:

	2004	2003
Operating activities	$ 518.1	$ 331.4
Investing activities	(114.0)	(248.5)
Financing activities	(396.2)	(177.5)

Cash flow statements for certain international operations that are local currency functional exclude the effects of the changes in foreign currency exchange rates that occur during any given period, as these are noncash charges. As a result, changes reflected in certain accounts on the consolidated condensed statements of cash flows may not reflect the changes in corresponding accounts on the consolidated condensed balance sheets.

Operating Activities

Cash flows from operating activities of continuing operations provided $518.1 million in the nine months ended September 30, 2004 compared with $331.4 million in the nine months ended September 30, 2003. This increase was primarily due to increased operating performance, which is directly related to our increased revenues. In addition, changes in working capital, primarily consisting of changes in accounts receivable, inventories, accounts payable and accrued employee compensation and other accrued liabilities, used $69.7 million less in cash flows during the nine months ended September 30, 2004 when compared to the nine months ended September 30, 2003.

The underlying drivers of the changes in working capital are as follows:

- An increase in accounts receivable due to increased activity used $111.2 million in cash in the first nine months of 2004 compared with using $52.1 million in cash in the first nine months of 2003.

- A build up of inventory in anticipation of increased activity used $42.1 million in cash in the first nine months of 2004 compared with using $57.8 million in the first nine months of 2003.

- An increase in accounts payable and accrued employee compensation and other accrued liabilities provided $76.4 million in cash in the first nine months of 2004 compared with using $36.7 million in cash in the first nine months of 2003. This was due primarily to better management of our accounts payable and $46.0 million less in net income tax payments in the first nine months of 2004 compared with the first nine months of 2003.

Investing Activities

Our principal recurring investing activity is the funding of capital expenditures to improve the productivity of our operations. Expenditures for capital assets totaled $242.3 million and $270.2 million for the nine months ended September 30, 2004 and 2003, respectively. The majority of these expenditures were for machinery and equipment and rental tools.

In September 2004, we completed the sale of BHMT and received $32.0 million in proceeds, which are subject to post-closing adjustments to the purchase price. In January 2004, we completed the sale of BIRD and received $5.6 million in proceeds, which were subject to post-closing adjustments to the purchase price. In June 2004, we made a net payment of $6.8 million to the buyer of BIRD in settlement of the final purchase price adjustments. The adjustments were the result of changes in the value of assets sold to and liabilities assumed by the buyer during the time frame in which the initial sales price was negotiated and the date of the closing of the sale. In February 2004, we also completed the sale of our minority interest in Petreco International for $35.8 million. We received $28.4 million in cash, with the remaining $7.4 million held in escrow pending the outcome of potential indemnification obligations pursuant to the sales agreement.

Proceeds from the disposal of assets were $81.8 million and $44.7 million for the nine months ended September 30, 2004 and 2003, respectively. These disposals related to rental tools that were lost-in-hole, as well as machinery, rental tools and equipment no longer used in operations that were sold throughout the period. Included in the proceeds for the nine months ended September 30, 2004 was $12.2 million related to the sale of certain real estate properties held for sale.

Financing Activities

We had net short-term debt payments of $6.5 million in the nine months ended September 30, 2004 compared with net short-term borrowings of $57.6 million in the nine months ended September 30, 2003. In the second quarter of 2004, we repaid the $100.0 million 8.0% Notes due May 2004 and the $250.0 million 7.875% Notes due June 2004. In the first quarter of 2003, we repaid the $100.0 million 5.8% Notes due February 2003. These repayments were funded with cash on hand, cash flows from operations and the issuance of commercial paper.

Total debt outstanding at September 30, 2004 was $1,121.4 million, a decrease of $363.0 million compared with December 31, 2003. The total debt to total capitalization (defined as total debt plus stockholders' equity) ratio was 0.23 at September 30, 2004 and 0.31 at December 31, 2003.

We received proceeds of $75.2 million and $38.1 million in the nine months ended September 30, 2004 and 2003, respectively, from the issuance of common stock through the exercise of stock options and our employee stock purchase plan.

During 2002, we were authorized by our Board of Directors to repurchase up to $275.0 million of our common stock. During the nine months ended September 30, 2003, we repurchased 2.5 million shares at an average cost of $28.69 per share, for a total of $72.9 million. Upon repurchase, the shares were retired. We did not repurchase any shares during the nine months ended September 30, 2004.

We paid dividends of $114.9 million and $115.8 million in the nine months ended September 30, 2004 and 2003, respectively.

Available Credit Facilities

At September 30, 2004, we had $886.1 million of credit facilities with commercial banks, of which $500.0 million is a committed revolving credit facility (the "facility") that expires in July 2006. The facility contains certain covenants which, among other things, require the maintenance of a funded indebtedness to total capitalization ratio (a defined formula per the facility) of less than or equal to 0.50, limit the amount of subsidiary indebtedness and restrict the sale of significant assets, defined as 10% or more of total consolidated assets. At September 30, 2004, we were in compliance with all of the facility covenants. There were no direct borrowings under the facility during the nine months ended September 30, 2004; however, to the extent we have outstanding commercial paper, our ability to borrow under the facility is reduced. At September 30, 2004, we had no outstanding commercial paper or money market borrowings. We have classified $8.9 million of short-term borrowings as long-term debt as we have both the ability under the facility and the intent to maintain these obligations for longer than one year.

If market conditions were to change and revenues were to be significantly reduced or operating costs were to increase, our cash flows and liquidity could be reduced. Additionally, it could cause the rating agencies to lower our credit rating. We do not have any ratings triggers in the facility that would accelerate the maturity of any borrowings under the facility. However, a downgrade in our credit ratings could increase the cost of borrowing under the facility. Also, a downgrade in our credit ratings could limit or preclude our ability to issue commercial paper. Should this occur, we would seek alternative sources of funding, including borrowing under the facility.

Cash Requirements

We believe operating cash flows combined with short-term borrowings, as needed, will provide us with sufficient capital resources and liquidity to manage our operations, meet contractual obligations, fund capital expenditures, repurchase common stock, pay dividends and support the development of our short-term and long-term operating strategies.

We currently expect that 2004 capital expenditures will be between $330.0 million and $350.0 million, excluding acquisitions. The expenditures are expected to be used primarily for normal, recurring items necessary to support the growth of our business and operations.

In 2004, we expect to make interest payments of approximately $100.0 million to $110.0 million. This is based on our current expectations of debt levels during 2004.

We have authorization remaining to repurchase up to $44.5 million in common stock. We may continue to repurchase our common stock in 2004 depending on the price of our common stock, our liquidity and other considerations. We anticipate paying dividends of $0.46 per share of common stock in 2004. However, our Board of Directors is free to change the dividend policy at any time.

In our consolidated financial statements for the year ended December 31, 2003, we disclosed that we expected to contribute approximately $35.0 million to $40.0 million to our pension plans during 2004. During the second quarter of 2004, we revised our estimate and now anticipate contributing approximately $45.0 million to $50.0 million to fund our pension plans in 2004. We estimate that we will make benefit payments related to postretirement welfare plans of approximately $14.0 million.

We anticipate making income tax payments of approximately $150.0 million to $180.0 million in 2004.

We do not believe that there are any other material trends, demands, commitments, events or uncertainties that would have, or are reasonably likely to have, a material impact on our financial condition and liquidity.

NEW ACCOUNTING STANDARDS

In January 2003, the Financial Accounting Standards Board (“FASB”) issued FASB Interpretation No. 46 (“FIN 46”), *Consolidation of Variable Interest Entities*. An entity is subject to the consolidation rules of FIN 46 and is referred to as a variable interest entity (“VIE”) if the entity’s equity investors lack the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its operations without additional financial support. In December 2003, the FASB issued modifications to FIN 46 (“FIN 46R”), resulting in multiple effective dates based on the nature as well as the creation date of a VIE. The adoption of FIN 46 and FIN 46R in 2004 had no impact on our consolidated condensed financial statements.

In May 2004, the FASB issued FASB Staff Position No. FAS 106-2 (“FSP 106-2”), *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003*, which provides guidance on the accounting for the effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 for employers that sponsor postretirement health care plans that provide prescription drug benefits. We adopted the provisions of FSP 106-2 in the third quarter of 2004, resulting in a reduction in our accumulated postretirement benefit obligation of $18.8 million. We recognized a reduction in our net periodic postretirement benefit costs of $0.7 million and $1.3 million for the three months and nine months ended September 30, 2004, respectively, as a result of the adoption of FSP 106-2. Results for the three months ended June 30, 2004 have been restated to reflect the retroactive application of FSP 106-2. The impact for the three months ended June 30, 2004 was an increase in income from continuing operations of $0.4 million, net of tax of $0.2 million. There was no impact on any other prior period.

FORWARD-LOOKING STATEMENTS

MD&A and certain statements in the Notes to Consolidated Condensed Financial Statements, as well as this report, include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The words “anticipate,” “believe,” “ensure,” “expect,” “if,” “intend,” “estimate,” “project,” “forecasts,” “predict,” “outlook,” “aim,” “will,” “could,” “should,” “would,” “may,” “likely” and similar expressions, and the negative thereof, are intended to identify forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statement. Our expectations regarding our business outlook, changes in profitability, customer spending, oil and natural gas prices and our business environment and the oil and natural gas industry in general are only our forecasts regarding these matters. These forecasts may be substantially different from actual results, which are affected by the following risk factors: the level of petroleum industry exploration and production expenditures; drilling rig and oil and natural gas industry manpower and equipment availability; our ability to implement and effect price increases for our products and services; our ability to control our costs; the rising costs and availability of sufficient raw materials, manufacturing capacity and subcontracting capacity at forecasted costs to meet our revenue goals; the effect of competition, particularly our ability to introduce new technology on a forecasted schedule and at forecasted costs; the ability of our competitors to capture market share; our ability to retain or increase our market share; potential impairment of long-lived assets; the accuracy of our estimates regarding our capital spending requirements; regulatory, legal and contractual impediments to spending reduction measures; changes in the levels of our capital expenditures due to the occurrence of any unanticipated transaction or research and development opportunities; changes in our strategic direction; the need to replace any unanticipated losses in capital assets; world economic conditions; the price of, and the demand for, crude oil and natural gas; drilling activity; seasonal and other weather conditions that affect the demand for energy and severe weather conditions, such as hurricanes, that affect exploration and production activities; the legislative, regulatory and business environment in the U.S. and other countries in which we operate; outcome of government and internal investigations and legal proceedings; receipt of license fees; changes in environmental regulations; unexpected, adverse outcomes or material increases in liability with respect to environmental remediation sites where we have been named as a potentially responsible party; the discovery of new environmental remediation sites; the discharge of hazardous materials or hydrocarbons into the environment; OPEC policy and the adherence by OPEC nations to their OPEC production quotas; war, military action or extended period of international conflict, particularly involving the U.S., Middle East or other major petroleum-producing or consuming regions; any future acts of war, armed conflicts or terrorist activities; civil unrest or in-country security concerns where we operate; expropriation; the development of technology by us or our competitors that lowers overall finding and development costs; new laws, regulations and policies that could have a significant impact on the future operations and conduct of all businesses; the effect of the level and sources of our profitability on our tax rate; changes in tax laws or tax rates in the jurisdictions in which we operate; resolution of audits by various tax authorities; ability to fully utilize our tax loss carryforwards and tax credits; labor-related actions, including strikes, slowdowns and facility occupations; the condition of the capital and equity markets in general; adverse foreign exchange fluctuations and adverse changes in the capital markets in international locations where we operate; and the timing of any of the foregoing. See “Key Risk Factors” for a more detailed discussion of certain of these risk factors.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We conduct operations around the world in a number of different currencies. The majority of our significant foreign subsidiaries have designated the local currency as their functional currency. As such, future earnings are subject to change due to changes in foreign currency exchange rates when transactions are denominated in currencies other than our functional currencies. To minimize the need for foreign currency forward contracts to hedge this exposure, our objective is to manage foreign currency exposure by maintaining a minimal consolidated net asset or net liability position in a currency other than the functional currency.

In April 2004, we entered into an interest rate swap agreement for a notional amount of $325.0 million associated with our 6.25% Notes due January 2009. Under this agreement we receive interest at a fixed rate of 6.25% and pay interest at a floating rate of six-month LIBOR plus a spread of 2.741%. The interest rate swap agreement has been designated and qualifies as a fair value hedging instrument. The interest rate swap agreement is fully effective, resulting in no gain or loss recorded in the consolidated condensed statement of operations. We recorded the fair value of the interest rate swap agreement, which was a $1.8 million liability at September 30, 2004 based on quoted market prices for contracts with similar terms and maturity dates.

At September 30, 2004, we had entered into several foreign currency forward contracts with notional amounts aggregating $86.0 million to hedge exposure to currency fluctuations in various foreign currencies, including the British Pound Sterling, the Euro, the Norwegian Krone, the Brazilian Real, and the Indonesian Rupiah. These contracts are designated and qualify as fair value hedging instruments. Based on quoted market prices as of September 30, 2004 for contracts with similar terms and maturity dates, we recorded a gain of $0.7 million to adjust these foreign currency forward contracts to their fair market value. This gain offsets designated foreign exchange losses resulting from the underlying exposures and is included in selling, general and administrative expense in the consolidated condensed statement of operations.

At September 30, 2004, we had entered into several foreign currency forward contracts with notional amounts aggregating $55.5 million to hedge exposure to currency fluctuations in the British Pound Sterling and the Canadian Dollar. These exposures arise when local currency operating expenses are not in balance with local currency revenue collections. The funding of such imbalances is supported by short-term intercompany borrowing commitments that have definitive amounts and funding dates. All fundings are scheduled to take place on or before December 31, 2004. These foreign currency forward contracts were designated as cash flow hedging instruments and are fully effective. Based on quoted market prices as of September 30, 2004 for contracts with similar terms and maturity dates, we recorded a loss of $1.0 million, net of tax of $0.6 million, to adjust these foreign currency forward contracts to their fair market value. This loss is recorded in other comprehensive income in the consolidated condensed balance sheet.

The counterparties to the forward contracts are major financial institutions. The credit ratings and concentration of risk of these financial institutions are monitored on a continuing basis. In the unlikely event that the counterparties fail to meet the terms of a foreign currency contract, our exposure is limited to the foreign currency rate differential.

Item 4. Controls and Procedures

As of the end of the period covered by this quarterly report, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). This evaluation was carried out under the supervision and with the participation of our management, including our principal executive officer and principal financial officer. Based on this evaluation, these officers have concluded that, as of September 30, 2004, our disclosure controls and procedures are functioning effectively to provide reasonable assurance that the information required to be disclosed by us in reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission (“SEC”) rules and forms. There has been no change in our internal controls over financial reporting during the quarter ended September 30, 2004 that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

Disclosure controls and procedures are our controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act, such as this quarterly report, is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On March 29, 2002, we announced that we had been advised that the Securities and Exchange Commission ("SEC") and the Department of Justice ("DOJ") are conducting investigations into allegations of violations of law relating to Nigeria and other related matters. The SEC has issued a formal order of investigation into possible violations of provisions under the Foreign Corrupt Practices Act ("FCPA") regarding anti-bribery, books and records and internal controls, and the DOJ has asked to interview current and former employees. On August 6, 2003, the SEC issued a subpoena seeking information about our operations in Angola and Kazakhstan as part of its ongoing investigation. We are providing documents to and cooperating fully with the SEC and DOJ. In addition, we are conducting internal investigations into these matters.

Our ongoing internal investigations have identified issues regarding the propriety of certain payments and apparent deficiencies in our books and records and internal controls with respect to certain operations in Nigeria, Angola and Kazakhstan, as well as potential liabilities to governmental authorities in Nigeria. The investigation in Nigeria was substantially completed during the first quarter of 2003 and, based upon current information, we do not expect that any such potential liabilities will have a material adverse effect on our results of operations or financial condition. The internal investigations in Angola and Kazakhstan were substantially completed in the third quarter of 2004. Evidence obtained during the course of the investigations has been provided to the SEC and DOJ.

The Department of Commerce, Department of the Navy and the DOJ (the "U.S. agencies") are investigating compliance with certain export licenses issued to Western Geophysical from 1994 through 2000 for export of seismic equipment leased by the People's Republic of China. We acquired Western Geophysical in August 1998 and subsequently transferred related assets to WesternGeco in December 2000. Under the joint venture formation agreement with WesternGeco, we owe indemnity to WesternGeco for certain matters. We are cooperating fully with the U.S. agencies.

We have received a subpoena from the grand jury in the Southern District of New York regarding goods and services delivered by us to Iraq from 1995 through 2003. We are in the process of responding to the subpoena. Other companies in the energy industry are believed to have received similar subpoenas.

The SEC, DOJ and other U.S. agencies and authorities have a broad range of sanctions they may seek to impose in appropriate circumstances including, but not limited to, injunctive relief, disgorgement, fines and penalties and modifications to business practices and compliance programs, as well as civil and criminal charges against individuals. It is not possible to accurately predict at this time when any of the investigations described above will be completed. Based on current information, we cannot predict the outcome of such investigations or what, if any, actions may be taken by the SEC, DOJ or other U.S. agencies or authorities or the effect it may have on us.

On May 10, 2004, the District Court of Andrews County, Texas entered a judgment in favor of LOTUS, LLC and against INTEQ in the amount of $14.8 million for lost profits resulting from a breach of contract in drilling a well to create a salt cavern for disposing of naturally occurring radioactive waste. We have filed an appeal and, while we believe we have a valid basis for appeal and intend to vigorously pursue it, our appeal could be denied and the judgment affirmed against INTEQ.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table contains information about our purchases of equity securities during the third quarter of 2004.

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased[1]	Average Price Paid per Share[1]	Total Number of Shares Purchased as Part of a Publicly Announced Plan	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plan[2,3]
July 1–31, 2004	3,788	$ 39.58	—	—
August 1–31, 2004	—	—	—	—
September 1–30, 2004	7,054	41.83	—	—
Total	10,842	$ 41.04	—	—

1 Represents shares purchased from employees to pay the option exercise price related to stock-for-stock exchanges in option exercises under employee benefit plans.

2 On September 10, 2002, we announced a plan to repurchase from time to time up to $275 million of our outstanding common stock. No shares have been repurchased in 2004 under the plan. The plan has no expiration date, but may be terminated by the Board of Directors at any time. Under the plan, we have authorization remaining to repurchase up to $44.5 million in common stock.

3 On September 3, 2004, we announced the commencement of a voluntary sale program (also known as an odd-lot program) for stockholders owning fewer than 100 shares of our common stock. The shares are sold on the open market by the program's administrator, Mellon Investor Services LLC. The program is not conditioned on receipt of a minimum number of tenders and is expected to expire on November 5, 2004, unless extended by us.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits

10.1 Employment Agreement by and between Baker Hughes Incorporated and Chad C. Deaton dated as of October 25, 2004 (filed as Exhibit 10.3 to Current Report on Form 8-K filed October 7, 2004).

10.2 Indemnification Agreement by and between Baker Hughes Incorporated and Chad C. Deaton dated as of October 25, 2004 (filed as Exhibit 10.1 to Current Report on Form 8-K filed October 7, 2004).

10.3 Change in Control Agreement by and between Baker Hughes Incorporated and Chad C. Deaton effective as of October 25, 2004 (filed as Exhibit 10.2 to Current Report on Form 8-K filed October 7, 2004).

10.4 Stock Option Agreement issued to Chad C. Deaton on October 25, 2004 in the amount of 75,000 shares of Company Common Stock.

10.5 Agreement regarding restricted stock award issued to Chad C. Deaton on October 25, 2004 in the amount of 80,000 shares of Company Common Stock.

10.6 Second Amended and Restated Stock Matching Agreement by and between Baker Hughes Incorporated and James R. Clark dated as of October 27, 2004.

10.7 Agreement regarding restricted stock award issued to James R. Clark on October 27, 2004 in the amount of 40,000 shares of Company Common Stock.

10.8 Form of Change in Control Severance Agreement between Baker Hughes Incorporated and Ray A. Ballantyne, David H. Barr, Trevor M. Burgess and John A. O'Donnell as of July 28, 2004 and with James R. Clark, Alan R. Crain, Jr., William P. Faubel, G. Stephen Finley, Edwin C. Howell, Greg Nakanishi and Douglas J. Wall to be effective as of January 1, 2006.

31.1 Certification of Chad C. Deaton, Chief Executive Officer, dated November 3, 2004, pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.

31.2 Certification of G. Stephen Finley, Chief Financial Officer, dated November 3, 2004, pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.

32 Statement of Chad C. Deaton, Chief Executive Officer, and G. Stephen Finley, Chief Financial Officer, dated November 3, 2004, furnished pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended.

SIGNATURES

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

	BAKER HUGHES INCORPORATED **(Registrant)**
Date: November 3, 2004	By: /s/G. STEPHEN FINLEY
	G. Stephen Finley Sr. Vice President — Finance and Administration and Chief Financial Officer
Date: November 3, 2004	By: /s/ALAN J. KEIFER
	Alan J. Keifer Vice President and Controller

EXHIBIT INDEX

Exhibits	Description of Exhibits
10.1	Employment Agreement by and between Baker Hughes Incorporated and Chad C. Deaton dated as of October 25, 2004 (filed as Exhibit 10.3 to Current Report on Form 8-K filed October 7, 2004).
10.2	Indemnification Agreement by and between Baker Hughes Incorporated and Chad C. Deaton dated as of October 25, 2004 (filed as Exhibit 10.1 to Current Report on Form 8-K filed October 7, 2004).
10.3	Change in Control Agreement by and between Baker Hughes Incorporated and Chad C. Deaton effective as of October 25, 2004 (filed as Exhibit 10.2 to Current Report on Form 8-K filed October 7, 2004).
10.4	Stock Option Agreement issued to Chad C. Deaton on October 25, 2004 in the amount of 75,000 shares of Company Common Stock.
10.5	Agreement regarding restricted stock award issued to Chad C. Deaton on October 25, 2004 in the amount of 80,000 shares of Company Common Stock.
10.6	Second Amended and Restated Stock Matching Agreement by and between Baker Hughes Incorporated and James R. Clark dated as of October 27, 2004.
10.7	Agreement regarding restricted stock award issued to James R. Clark on October 27, 2004 in the amount of 40,000 shares of Company Common Stock.
10.8	Form of Change in Control Severance Agreement between Baker Hughes Incorporated and Ray A. Ballantyne, David H. Barr, Trevor M. Burgess and John A. O’Donnell as of July 28, 2004 and with James R. Clark, Alan R. Crain, Jr., William P. Faubel, G. Stephen Finley, Edwin C. Howell, Greg Nakanishi and Douglas J. Wall to be effective as of January 1, 2006.
31.1	Certification of Chad C. Deaton, Chief Executive Officer, dated November 3, 2004, pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
31.2	Certification of G. Stephen Finley, Chief Financial Officer, dated November 3, 2004, pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
32	Statement of Chad C. Deaton, Chief Executive Officer, and G. Stephen Finley, Chief Financial Officer, dated November 3, 2004, furnished pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended.

Exhibit 10.4

BAKER HUGHES INCORPORATED
STOCK OPTION AGREEMENT

Chad Deaton
Grantee

Date of Grant:	**October 25, 2004**
Total Number of Shares Granted:	**75,000**
Exercise Price per Share:	**$43.39**
Expiration Date:	**October 25, 2014**
Term of Award; Vesting Schedule:	**3 years, with vesting of 33 1/3% on the anniversary date of the Date of Grant in each of the years 2005, 2006, and 2007.**
Other Terms of Award:	**Terms and Conditions are provided upon request and are located on the BHI Intranet at**: **http://interchange/humanresources/Compensation**

GRANT OF OPTION

Pursuant to action taken by the Compensation Committee of the Board of Directors of Baker Hughes Incorporated, a Delaware corporation (the "Company"), for the purposes of administration of the **Baker Hughes Incorporated 2002 Director & Officer Long-Term Incentive Plan** (the "Plan"), the above-named Grantee is hereby granted a non-qualified stock option to purchase the above number of shares of the Company's $1 par value per share common stock at the exercise price stated above for each share subject to this option, with the exercise price payable at the time of exercise. This option may not be exercised after the Expiration Date.

By your acceptance of the option, you agree that the option is granted under and governed by the terms of the Plan, this Stock Option Agreement and the Terms and Conditions of Option Agreements dated July 28, 2004.

BAKER HUGHES INCORPORATED

H. John Riley, Jr.
Chairman, Compensation Committee
of the Board of Directors of
Baker Hughes Incorporated

Exhibit 10.5

October 26, 2004

Mr. Chad C. Deaton
13914 I.O. Court
Willis, Texas 77318

Dear Chad:

On October 25, 2004, Baker Hughes Incorporated (the "Company") awarded you 80,000 restricted shares of the Common Stock of the Company, subject to the restrictions, terms and conditions described in your Employment Agreement. A certificate representing the 80,000 shares will be issued in your name and held in the Company's possession for safekeeping until they vest in accordance with the restrictions, terms and conditions contained in the resolutions, at which time the Company will deliver the shares to you.

Pending vesting of the restricted shares, you will earn dividends paid with respect to the shares.

Sincerely yours,

/s/ H. John Riley, Jr.
H. John Riley, Jr.
Chairman, Compensation Committee
of the Board of Directors of
Baker Hughes Incorporated

Exhibit 10.6

SECOND AMENDED AND RESTATED
STOCK MATCHING AGREEMENT

This Second Amended and Restated Stock Matching Agreement (this "Agreement") is made and entered into this 27th day of October, 2004, by and between Baker Hughes Incorporated, a Delaware corporation (the "Company"), and James Roderick Clark (the "Employee"), regarding the award of Matched Shares (defined below) to the Employee pursuant to the Long Term Incentive Plan of Baker Hughes Incorporated (the "Plan"), and further subject to the terms and conditions set forth below.

W I T N E S S E T H:

WHEREAS, the Company and the Employee previously entered into that certain Stock Matching Agreement dated March 1, 2002, as amended on March 6, 2002, which was Amended and Restated on December 3, 2003 (as amended and restated, the "Original Agreement");

WHEREAS, the Company and the Employee recognize that there will no longer be a "substantial risk of forfeiture" under this Agreement for federal income tax purposes on and after March 7, 2006, when the Employee is eligible to "retire" for purposes of this Agreement;

WHEREAS, the Company and the Employee desire to make certain changes to the Original Agreement in order to provide for Employee to sell Matched Shares (as defined below) to pay tax liabilities in connection with income being attributed to Employee under this Agreement and to allow Employee to sell Common Stock of the Company previously obtained by Employee in the open market in connection with the Original Agreement; and

WHEREAS, the Company and the Employee desire to amend and restate the Original Agreement in its entirety and, unless otherwise set forth herein, all terms and provisions hereof are effective as of the date first written above;

NOW, THEREFORE, in consideration of the premises and mutual covenants and agreements contained herein, the parties hereto hereby agree to amend and restate the Original Agreement and agree as follows:

1. **Award of Matched Shares**. The Company hereby issues, subject to all the terms and conditions in this Agreement, 25,000 restricted shares (the "Restricted Stock") of the Company's common stock, $1.00 par value per share ("Common Stock"), which represents one share for each share of Common Stock up to, but not exceeding, 25,000 shares of Common Stock owned, and held of record, (x) by the Employee and (y) for the benefit of the Employee in an account by (i) a tax-qualified plan maintained by the Company, a Subsidiary or a former employer of the Employee, and/or (ii) an individual retirement account or annuity under Code Section 408 or 408A (with such shares under this clause (y) deemed to be owned by the Employee for purposes of this Agreement) at the close of business on September 2, 2002. Such shares of Restricted Stock shall be referred to herein as the "Matched Shares."

2. **Substantial Risk of Forfeiture.** The Matched Shares that are granted hereby shall be subject to a substantial risk of forfeiture ("Forfeiture Restrictions") until

the earlier to occur of (a) March 7, 2006, or (b) a "Transferability Event" (as defined in Section 3). In the event of the occurrence of a Forfeiture Event (as defined in Section 3) prior to the lapse of the Forfeiture Restrictions, all the Matched Shares shall be forfeited to the Company.

3. **Transfer Restrictions.** Except as specified in Section 3(III), the Matched Shares granted hereby may not be sold, assigned, pledged, exchanged, hypothecated or otherwise transferred, encumbered or disposed of prior to the occurrence of a Transferability Event. Any such attempted sale, assignment, pledge, exchange, hypothecation, transfer, encumbrance or disposition in violation of this Agreement shall be void and the Company shall not be bound thereby. If a Forfeiture Event occurs before the occurrence of a Transferability Event, the Matched Shares shall be forfeited to the Company.

(I) Transferability Events. For purposes of this Agreement, the following are Transferability Events:

(a) The Retirement of the Employee;

(b) The termination of the Employee's employment by the Company without Non-CIC Cause;

(c) The occurrence of a Change in Control;

(d) The termination of the Employee's employment:

(i) by the Company without CIC Cause prior to a Change in Control (whether or not a Change in Control ever occurs) if such termination was at the request or direction of a person who has entered into an agreement with the Company, the consummation of which would constitute a Change in Control;

(ii) by the Employee for Good Reason prior to a Change in Control (whether or not a Change in Control ever occurs) if the circumstance or event which constitutes Good Reason occurs at the request or direction of the Person described in the foregoing clause (i); or

(iii) by the Company without CIC Cause or by the employee for Good Reason if such termination or the circumstance or event which constitutes Good Reason is otherwise in connection with, or in anticipation of, a Change in Control (whether or not a Change in Control ever occurs; or

(e) The Employee's death or permanent disability (as determined by the Committee in its sole discretion).

(II) Forfeiture Event: For purposes of this Agreement, a Forfeiture Event means the termination of employment of the Employee other than as set forth in Section 3(I) or due to Non-CIC Cause.

(III) Tax Trigger Event: Upon the lapse of the Forfeiture Restrictions under Section 2 (a "Tax Trigger Event") with respect to the Matched Shares granted to Employee (not including dividends paid on the Matched Shares), the Employee shall be allowed to satisfy the Company's tax withholding obligations by having the Company hold back a portion of the Matched Shares with a fair market value equal to the minimum statutory withholding obligations of the Company under applicable laws at the time of the Tax Trigger Event for the amount Employee is required to recognize as income in connection with the Tax Trigger Event.

4. **Forfeiture of Matched Shares**. Upon the forfeiture of Matched Shares pursuant to Section 2 of Section 3 of this Agreement the Employee shall forfeit, for all purposes of this Agreement and without consideration, any and all rights and have no further claim against or with respect to any such forfeited Matched Shares or against the Company for any such forfeited Matched Shares.

5. **Stock Certificates**. The Company will issue a stock certificate for the Matched Shares in the name of the Employee; *provided* that the Secretary of the Company will hold the stock certificate(s) representing such shares and any additional shares issued as a result of a stock dividend or stock split (as provided in Section 9) until the occurrence of a Vesting Event or Forfeiture Event.

6. **Shareholder Status**. The Employee will have (i) the right to receive all cash dividends on the Matched Shares, subject to forfeiture of such shares under Sections 2 and 3, and (ii) the right to vote such shares, subject to forfeiture of such shares under Sections 2 and 3. If the Matched Shares are forfeited pursuant to Section 2 or 3, the Employee will at the same time forfeit the Employee's right to vote such shares and to receive future cash dividends and any other distributions made with respect to such shares. Any distributions made with respect to the Matched Shares (other than cash dividends) shall be deemed to be a portion of the Matched Shares and held by the Secretary of the Company subject to the terms and conditions of this Agreement.

7. **Ownership by the Employee**. The Employee shall have no obligations to continue to own any minimum amount of Common Stock under this Agreement. However, this will not relieve the Employee of any obligation to own Common Stock under other agreements with the Company or the policies of the Company applicable to its senior executives.

8. **Limitation of Award**. The award of shares of Common Stock to the Employee pursuant to this Agreement is being made only with respect to the shares owned on September 2, 2002. No future award of shares is being authorized pursuant hereto and may only be made by the Committee in its sole discretion at such time in the future. No increase in shares subsequent to September 2, 2002 shall create a right to an increase in the number of Matched Shares.

9. **Adjustments**. If the Company should declare a stock dividend or authorize a split of shares of the Common Stock of the Company, the Matched Shares shall reflect and to take into account such stock dividend or stock split, as the case may be. The additional shares to be issued as a result of such stock dividend or stock split shall be deemed to be a portion of the Matched Shares and subject to the terms and conditions of this Agreement.

10. **Relationship to the Plan; Definitions**. This award of Matched Shares is granted under the Plan and is subject to all of the terms, conditions and provisions of the Plan and administrative interpretations thereunder, if any, which have been adopted by the Committee thereunder and are in effect on the date hereof. Capitalized terms that are not defined in this Agreement shall have the same meanings ascribed to them under the Plan. For purposes of this Agreement:

(a) "CIC Cause" means Cause as defined in the Plan.

(b) "Retirement" means the termination of employment after attaining age 55 with not less than 5 years of continuous employment since the Employment Date with the Company; provided, however, that such termination is not due to CIC Cause or Non-CIC Cause.

(c) "Non-CIC Cause" means fraud, theft, embezzlement committed against the Company or an Affiliate or a customer of the Company or an Affiliate, or conflict of interest, unethical conduct, dishonesty affecting the assets, properties or businesses of the Company or any of its Affiliates, willful misconduct, or continued material dereliction of duties.

11. **Withholding**. To the extent the issuance of the Matched Shares under this Agreement results in taxable income to the Employee, the Company is authorized to withhold from any remuneration payable to the Employee any tax required to be withheld by reason of such taxable income.

12. **Entire Agreement**. This Agreement is intended by the parties hereto to be the final expression of their Agreement with respect to the subject matter hereof and is the complete and exclusive statement thereof notwithstanding any prior representation or statements to the contrary. This Agreement hereby supercedes the Original Agreement.

This Agreement may be modified only by written instrument signed by each of the parties hereto.

13. **Headings and Sections**. The headings contained in this Agreement are for reference purposes only and do not affect in any way the meaning or interpretation of this Agreement. All references to sections in this Agreement shall be to sections of this Agreement unless otherwise indicated.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

BAKER HUGHES INCORPORATED

BY /s/ Chad C. Deaton
Chad C. Deaton
Chairman and Chief Executive Officer

Acknowledgment, Acceptance and Consent by the Employee

The undersigned Employee, James Roderick Clark, hereby agrees to, and accepts, the terms and provisions of the foregoing Second Amended and Restated Stock Matching Agreement, subject to the terms and provisions of the Plan and administrative interpretations thereof referred to above. The undersigned further hereby acknowledges that he has received a copy of the Long Term Incentive Plan of Baker Hughes Incorporated and that he has been advised by the Company to consult with and rely upon only his own tax, legal and financial advisors regarding the consequences and risks of this award.

Date	James Roderick Clark 10893 Lake Forest Drive Conroe, Texas 77384

Consent of Spouse of the Employee

The undersigned spouse of the Employee has read and hereby approves the terms and conditions of the foregoing Second Amended and Restated Stock Matching Agreement and the Plan. In consideration of the Company's awarding the Employee the Matched Shares, as set forth in the Agreement, the undersigned hereby agrees and consents to be irrevocably bound by the terms and conditions of the Agreement and the Plan and further agrees that any community property interest shall be similarly bound. The undersigned hereby appoints the undersigned's spouse as attorney-in-fact for the undersigned with respect to any amendment or exercise of rights under the Agreement and the Plan.

Spouse of the Employee

Exhibit 10.7

October 28, 2004

Mr. James R. Clark
10893 Lake Forest Drive
Conroe, Texas 77384

Dear Rod:

On October 27, 2004, Baker Hughes Incorporated (the "Company") awarded you 40,000 restricted shares of the Common Stock of the Company, subject to the restrictions, terms and conditions described in the enclosed certified resolutions of the Compensation Committee of the Board of Directors of the Company. A certificate representing the 40,000 shares will be issued in your name and held in the Company's possession for safekeeping until they vest in accordance with the restrictions, terms and conditions contained in the resolutions, at which time the Company will deliver the shares to you.

Pending vesting of the restricted shares, you will earn dividends paid with respect to the shares.

Sincerely yours,

/s/ Chad C. Deaton

Chad C. Deaton

enclosure

CERTIFICATE

The undersigned, Sandra E. Alford, hereby certifies that she is the duly elected, qualified and acting Corporate Secretary of Baker Hughes Incorporated, a corporation duly organized and existing under the laws of the State of Delaware (the “Company”); that as such officer, she is in charge of the Minute Book and other corporate records of said Company; that the following is a full, true and correct copy of the resolutions appearing in the records of the Company, that said resolutions were adopted at a meeting of the Compensation Committee of the Board of Directors of the Company on October 27, 2004; and that the undersigned further certifies that as of the date hereof said resolutions have not been rescinded or modified and are in full force and effect:

RESOLVED, that the Company issue to James R. Clark 40,000 restricted shares of the Common Stock of the Company, $1.00 par value per share (the “Restricted Shares”) under the Company’s 2002 Director & Officer Long-Term Incentive, of which 10,000 shares are to vest on October 27 in the years 2007 and 2008 and 20,000 are to vest on October 27, 2009, subject to continued employment with the Company;

RESOLVED FURTHER, that if Mr. Clark does not remain employed by the Company other than by death or disability, the Restricted Shares shall be forfeited to the Company to become treasury shares of the Company;

RESOLVED FURTHER, that in the event Mr. Clark does not remain employed by the Company due to his disability, all Restricted Shares shall immediately vest;

RESOLVED FURTHER, that upon the death of the employee while in active service, all Restricted Shares shall immediately vest with the estate of the deceased being the beneficiary;

RESOLVED FURTHER, that pending vesting of the Restricted Shares, Mr. Clark shall be entitled to dividends paid with respect to the Restricted Shares;

RESOLVED FURTHER, that the Restricted Shares shall be issued pursuant to the 2002 Director & Officer Long Term Incentive Plan of the Company and are subject to and governed by the additional terms and conditions of that Plan, including (without limitation) the change of control provisions of Section 16 of the Plan;

RESOLVED FURTHER, that when the Restricted Shares are issued and delivered to Mr. Clark, they shall be fully paid and non-assessable and subject to the conditions described above;

RESOLVED FURTHER, that the proper officers of the Company be, and each of them hereby is, authorized to prepare, execute, deliver and perform such agreements, documents, certificates and other instruments and take such other action, in the name and on behalf of the Company, as each of such officers, in the officer’s discretion, shall deem necessary or advisable to carry out the intent of the foregoing resolutions and the transactions contemplated thereby, the taking of such action and the preparation, execution, delivery and performance of any such agreements, documents, certificates and other instruments or the performance of any such act shall be conclusive evidence of the approval of this Board of Directors thereof and all matters relating thereto; and

RESOLVED FURTHER, that any and all actions taken by or on behalf of the officers of the Company prior to the adoption of these resolutions that are within the authority conferred hereby are hereby in all respects ratified, confirmed and approved.

Dated at Houston, Texas this 27th day of October 2004.

/s/ Sandra E. Alford

Sandra E. Alford
Corporate Secretary

Exhibit 10.8

SEVERANCE AGREEMENT

THIS AGREEMENT, is entered into by and between BAKER HUGHES INCORPORATED, a Delaware corporation (the “Company”), and (the “Executive”) on , but effective for all purposes as of (the “Effective Date”).

WHEREAS, the Company recognizes that one of its most valuable assets is its key management executives; and

WHEREAS, the Company recognizes that, as is the case with many publicly-held corporations, the possibility of a Change in Control exists and that such possibility, and the uncertainty and questions which it may raise among management, may result in the departure or distraction of management personnel to the detriment of the Company and its stockholders; and

WHEREAS, the Company would like to provide severance benefits in the event that the employment of a key management executive is involuntarily terminated in conjunction with a change in control;

NOW, THEREFORE, in consideration of the premises and the mutual covenants herein contained, the Company and the Executive hereby agree as follows:

1. Defined Terms. For purposes of this Agreement, the following terms shall have the meanings indicated below:

“Affiliate” means any entity which is a member of (i) the same controlled group of corporations within the meaning of section 414(b) of the Code with Baker Hughes, (ii) a trade or business (whether or not incorporated) which is under common control (within the meaning of section 414(c) of the Code) with Baker Hughes or (iii) an affiliated service group (within the meaning of section 414(m) of the Code) with Baker Hughes.

“Annual Incentive Plan” means the Baker Hughes Incorporated 1995 Employee Annual Incentive Compensation Plan, as amended and/or restated from time to time, any guidelines issued pursuant to such plan, and any other incentive compensation plans adopted by the Company from time to time which are in replacement of or in addition to such plan.

“Assets” means assets of any kind owned by Baker Hughes, including but not limited to securities of Baker Hughes’ direct and indirect subsidiaries and Affiliates.

“Baker Hughes” means Baker Hughes Incorporated, a Delaware corporation, and any successor by merger or otherwise.

“Base Compensation” means a Executive’s base salary or wages (as defined in section 3401(a) of the Code for purposes of federal income tax withholding) from the Company, modified by including any portion thereof that such Executive could have received in cash in lieu of any elective deferrals made by the Executive pursuant to the Supplemental Retirement Plan (other than deferrals of bonuses) or pursuant to a qualified cash or deferred arrangement described in section 401(k) of the Code and any elective contributions under a cafeteria plan described in section 125, and modified further by excluding any bonus, incentive compensation (including but not limited to equity-based compensation), commissions, expense reimbursements or other expense allowances, fringe benefits (cash and noncash), moving expenses, deferred compensation (other than elective deferrals by the Executive under a qualified cash or deferred arrangement described in section 401(k) of the Code or the Supplemental Retirement Plan that are expressly included in "Base Compensation" under the foregoing provisions of this definition), welfare benefits as defined in ERISA, overtime pay, special performance compensation amounts and severance compensation.

"Beneficial Owner" or "Beneficial Ownership" shall have the meaning ascribed to those terms in Rule 13d-3 of the General Rules and Regulations under the Exchange Act.

"Board" means the Board of Directors of Baker Hughes or other governing body of Baker Hughes or its direct or indirect parent.

"Bonus" means each annual incentive bonus, if any, paid in cash by the Company to or for the benefit of an Employee for services rendered or labor performed while an Employee. Annual bonuses are generally paid with respect to a completed fiscal year by the Company to its employees pursuant to the Annual Incentive Plan. An Employee's Bonus shall be determined by including any portion thereof that such Executive could have received in cash in lieu of (i) any elective deferrals made by such Executive pursuant to the Supplemental Retirement Plan or (ii) elective contributions made on such Executive's behalf by the Company pursuant to a qualified cash or deferred arrangement (as defined in section 401(k) of the Code) or pursuant to a plan maintained under section 125 of the Code.

"Cause" means (i) the willful and continued failure by the Employee to substantially perform the Employee's duties with the Company (other than any such failure resulting from the Employee's incapacity due to physical or mental illness) after a written demand for substantial performance is delivered to the Employee by the Board (or by a delegate appointed by the Board), which demand specifically identifies the manner in which the Board believes that the Employee has not substantially performed the Employee's duties, or (ii) the willful engaging by the Employee in conduct which is demonstrably and materially injurious to the Company or any of its Affiliates, monetarily or otherwise. For purposes of Sections (i) and (ii) of this definition, (A) no act, or failure to act, on the Employee's part shall be deemed "willful" if done, or omitted to be done, by the Employee in good faith and with reasonable belief that the act, or failure to act, was in the best interest of the Company and (B) in the event of a dispute concerning the application of this provision, no claim by the Company that Cause exists shall be given effect unless the Company establishes to the Board by clear and convincing evidence that Cause exists.

"Change in Control" means the occurrence of any of the following events:

(a) the individuals who are Incumbent Directors cease for any reason to constitute a majority of the members of the Board;

(b) the consummation of a Merger of Baker Hughes or an Affiliate of Baker

Hughes with another Entity, unless the individuals and Entities who were the Beneficial Owners of the Voting Securities of Baker Hughes outstanding immediately prior to such Merger own, directly or indirectly, at least 50 percent of the combined voting power of the Voting Securities of any of Baker Hughes, the surviving Entity or the parent of the surviving Entity outstanding immediately after such Merger;

(c) any Person, other than a Specified Owner, becomes a Beneficial Owner, directly or indirectly, of securities of Baker Hughes representing 30 percent or more of the combined voting power of Baker Hughes' then outstanding Voting Securities;

(d) a sale, transfer, lease or other disposition of all or substantially all of Baker Hughes' Assets is consummated (an "Asset Sale"), unless:

(1) the individuals and Entities who were the Beneficial Owners of the Voting Securities of Baker Hughes immediately prior to such Asset Sale own, directly or indirectly, 50 percent or more of the combined voting power of the Voting Securities of the Entity that acquires such Assets in such Asset Sale or its parent immediately after such Asset Sale in substantially the same proportions as their ownership of Baker Hughes' Voting Securities immediately prior to such Asset Sale; or

(2) the individuals who comprise the Board immediately prior to such Asset Sale constitute a majority of the board of directors or other governing body of either the Entity that acquired such Assets in such Asset Sale or its parent (or a majority plus one member where such board or other governing body is comprised of an odd number of directors); or

(e) The stockholders of Baker Hughes approve a plan of complete liquidation or dissolution of Baker Hughes.

"Code" means the Internal Revenue Code of 1986, as amended, or any successor act.

"Committee" means, prior to a Change in Control or a Potential Change in Control, the Compensation Committee of the Board. After a Change in Control or a Potential Change in Control, "Committee" means (i) the individuals (not fewer than three (3) in number) who, on the date six months prior to the Change in Control constitute the Compensation Committee of the Board, plus, (ii) in the event that fewer than three (3) individuals are available from the group specified in clause (i) above for any reason, such individuals as may be appointed by the individual or individuals so available (including for this purpose any individual or individuals previously so appointed under this clause (ii)); provided, however, that the maximum number of individuals constituting the Committee after a Change in Control or Potential Change in Control shall not exceed six (6).

"Company" means Baker Hughes. In the event that the Executive's employer is a subsidiary of Baker Hughes, Company shall include the Executive's employer where appropriate and Baker Hughes will cause the Executive's employer to take any actions necessary to satisfy the obligations of the Company under this Agreement.

"Disability" means the Executive's incapacity due to physical or mental illness that has caused the

Executive to be absent from full-time performance of his duties with the Company for a period of six (6) consecutive months.

"Effective Date" means the date identified in the introduction of this Agreement..

"Employee" means an individual (i) who is employed in the services of the Company on the Company's active payroll, and (ii) who is also a United States-based executive salary grade system employee (under the Company's then current payroll system categories), or any comparable executive designations in any system that replaces the United States-based salary grade system.

"Employment Termination Date" means the date as of which Executive incurs a Termination of Employment determined in accordance with the provisions of Section 5.2.

"Entity" means any corporation, partnership, association, joint-stock company, limited liability company, trust, unincorporated organization or other business entity.

"ERISA" means the Employee Retirement Income Security Act of 1974, as amended, or any successor act.

"Exchange Act" means the Securities Exchange Act of 1934, as amended, or any successor act.

"Excise Tax" means the excise tax imposed by section 4999 of the Code or any similar tax payable under any United States federal, state, or local statute.

"Executive" means the Employee identified in the introduction of this Agreement.

"Expiration Date" shall have the meaning specified in Section 2 of this Agreement.

"Good Reason" for termination by the Employee of his employment means the occurrence (without the Employee's express written consent) after any Change in Control, or prior to a Change in Control under the circumstances described in clauses (ii) and (iii) of the second paragraph of the definition of Termination of Employment (treating all references to "Change in Control" in paragraphs (a) through (f) below as references to a "Potential Change in Control"), of any one of the following acts by the Company, or failures by the Company to act, unless, in the case of any act or failure to act described in paragraph (a), (e), (f) or (g) below, such act or failure to act is corrected prior to the effective date of the Employee's termination for Good Reason:

(a) the assignment to the Employee of any duties or responsibilities which are substantially diminished as compared to the Employee's duties and responsibilities immediately prior to a Change in Control or a material change in the Employee's reporting responsibilities, titles or offices as an Employee and as in effect immediately prior to the Change in Control.

(b) a reduction by the Company in the Employee's annual Base Compensation as in effect on the date hereof or as the same may be increased from time to time, except for across-the-board salary reductions similarly affecting all individuals having a similar level of authority and responsibility with the Company and all individuals having a similar level of authority and responsibility with any Person in control of the Company;

(c) the relocation of the Employee's principal place of employment to a location outside of a 50-mile radius from the Employee's principal place of employment immediately prior to the Change in Control or the Company's requiring the Employee to be based anywhere other than such principal place of employment (or permitted relocation thereof) except for required travel on the Company's business to an extent substantially consistent with the Employee's business travel obligations immediately prior to a Change in Control;

(d) the failure by the Company to pay to the Employee any portion of the Employee's current compensation except pursuant to an across-the-board compensation deferral similarly affecting all individuals having a similar level of authority and responsibility with the Company and all individuals having a similar level of authority and responsibility with any Person in control of the Company, or to pay to the Employee any portion of an installment of deferred compensation under any deferred compensation program of the Company, within seven (7) days of the date such compensation is due;

(e) the failure by the Company to continue in effect any compensation plan in which the Employee participates immediately prior to the Change in Control which is material to the Employee's total compensation, unless an equitable arrangement (embodied in an ongoing substitute or alternative plan) has been made with respect to such plan, or the failure by the Company to continue the Employee's participation therein (or in such substitute or alternative plan) on a basis not materially less favorable, both in terms of the amount or timing of payment of benefits provided and the level of the Employee's participation relative to other Executives, as existed immediately prior to the Change in Control;

(f) the failure by the Company to continue to provide the Employee with benefits substantially similar to those enjoyed by the Employee under any of the Company's pension, savings, life insurance, medical, health and accident, or disability plans in which the Employee was participating immediately prior to the Change in Control (except for across the board changes similarly affecting all individuals having a similar level of authority and responsibility with the Company and all individuals having a similar level of authority and responsibility with any Person in control of the Company), the taking of any other action by the Company which would directly or indirectly materially reduce any of such benefits or deprive the Employee of any material fringe benefit or Perquisite enjoyed by the Employee at the time of the Change in Control, or the failure by the Company to provide the Employee with the number of paid vacation days to which the Employee is entitled on the basis of years of service with the Company in accordance with the Company's normal vacation policy in effect immediately prior to the time of the Change in Control; or

(g) any purported termination of the Employee's employment which is not effected pursuant to a notice of termination satisfying the requirements of Section 5.1 hereof.

The Employee's right to terminate his employment for Good Reason shall not be affected by the Employee's incapacity due to physical or mental illness. The Employee's continued employment shall not constitute consent to, or a waiver of any rights with respect to, any act or failure to act constituting Good Reason hereunder.

For purposes of any determination regarding the existence of Good Reason, any claim by the Employee that Good Reason exists shall be presumed to be correct unless the Company establishes to the Committee by clear and convincing evidence that Good Reason does not exist. The Committee's determination regarding the existence of Good Reason shall be conclusive and binding upon all parties unless the Committee's determination is arbitrary and capricious.

"Gross-Up Payment" means the additional amount paid to a Executive pursuant to Section 3.4.

"Highest Base Compensation" means the Executive's annualized Base Compensation in effect immediately prior to (1) a Change in Control, (2) the first event or circumstance constituting Good Reason, or (3) the Executive's Termination of Employment, whichever is greatest.

"Incumbent Director" means –

(a) a member of the Board on the Effective Date; or

(b) an individual-

(1) who becomes a member of the Board after the Effective Date;

(2) whose appointment or election by the Board or nomination for election by Baker Hughes' stockholders is approved or recommended by a vote of at least two-thirds of the then serving Incumbent Directors (as defined herein); and

(3) whose initial assumption of service on the Board is not in connection with an actual or threatened election contest.

"Merger" means a merger, consolidation or similar transaction.

"Pension Plan" means the Baker Hughes Incorporated Pension Plan, as amended from time to time.

"Perquisites" means benefits such as any airline VIP club memberships; country club and/ or health club membership dues and expenses related to the use of the country club and/ or health club; supplemental life insurance; financial consulting; and office equipment for use in the home (e.g., cellular telephones, personal digital assistance, home computers and office accessories similar to the office accessories available to the Executive in his employment office and monthly Internet connection fees) that may be provided by the Company from time to time.

"Person" shall have the meaning ascribed to the term in Section 3(a)(9) of the Exchange Act and used in Sections 13(d) and 14(d) thereof, including a "group" as defined in Section 13(d) thereof, except that the term shall not include (a) the Company or any of its Affiliates, (b) a trustee or other fiduciary holding Company securities under an employee benefit plan of the Company or any of its Affiliates, (c) an underwriter temporarily holding securities pursuant to an offering of those securities or (d) a corporation owned, directly or indirectly, by the stockholders of the Company in substantially the same proportions as their ownership of stock of the Company.

"Potential Change in Control" shall be deemed to have occurred if the event set forth in any one of the following paragraphs shall have occurred:

(a) the Company enters into an agreement, the consummation of which would result in the occurrence of a Change in Control;

(b) the Company or any Person publicly announces an intention to take or to consider taking actions which, if consummated, would constitute a Change in Control;

(c) any Person becomes the Beneficial Owner, directly or indirectly, of securities of the Company representing 15 percent or more of either the then outstanding shares of common stock of the Company or the combined voting power of the Company's then outstanding securities (not including in the securities beneficially owned by such Person any securities acquired directly from the Company or its Affiliates); or

(d) the Board adopts a resolution to the effect that, for purposes of this Agreement, a Potential Change in Control has occurred.

"Renewal Date" shall have the meaning specified in Section 2 of this Agreement.

"Specified Owner" means any of the following:

(a) Baker Hughes;

(b) an Affiliate of Baker Hughes;

(c) an employee benefit plan (or related trust) sponsored or maintained by Baker Hughes or any Affiliate of Baker Hughes;

(d) a Person that becomes a Beneficial Owner of Baker Hughes' outstanding Voting Securities representing 30 percent or more of the combined voting power of Baker Hughes' then outstanding Voting Securities as a result of the acquisition of securities directly from Baker Hughes and/or its Affiliates; or

(e) a Person that becomes a Beneficial Owner of Baker Hughes' outstanding Voting Securities representing 30 percent or more of the combined voting power of Baker Hughes' then outstanding Voting Securities as a result of a Merger if the individuals and Entities who were the Beneficial Owners of the Voting Securities of Baker Hughes outstanding immediately prior to such Merger own, directly or indirectly, at least 50 percent of the combined voting power of the Voting Securities of any of Baker Hughes, the surviving Entity or the parent of the surviving Entity outstanding immediately after such Merger in substantially the same proportions as their ownership of the Voting Securities of Baker Hughes outstanding immediately prior to such Merger.

"Supplemental Retirement Plan" means the Baker Hughes Incorporated Supplemental Retirement Plan, as amended from time to time.

"Termination of Employment" means the termination of an individual's employment relationship with the Company (i) by the Company without Cause after a Change in Control occurs, or (ii) by the individual for Good Reason after a Change in Control occurs.

For purposes of this definition, an individual's employment shall be deemed to have been terminated after a Change in Control, if (i) the individual's employment is terminated by the Company without Cause prior to a Change in Control (whether or not a Change in Control ever occurs) and such termination was at the request or direction of a Person who has entered into an agreement with the Company, the consummation of which would constitute a Change in Control; (ii) the individual terminates his employment for Good Reason prior to a Change in Control (whether nor not a Change in Control ever occurs) and the circumstance or event which constitutes Good Reason occurs at the request or direction of a Person who has entered into an agreement with the Company, the consummation of which would constitute a Change in Control; or (iii) the individual's employment is terminated by the Company without Cause or by the individual for Good Reason and such termination or the circumstance or event which constitutes Good Reason is otherwise in connection with or in anticipation of a Change in Control (whether or not a Change in Control ever occurs). For purposes of any determination regarding the applicability of the immediately preceding sentence, any position taken by the Executive shall be presumed to be correct unless the Company establishes to the Committee by clear and convincing evidence that such position is not correct.

Termination of Employment does not include (i) a termination of employment due to the individual's death or Disability, or (ii) a termination of employment by the individual without Good Reason.

"Thrift Plan" means the Baker Hughes Incorporated Thrift Plan, as amended from time to time.

"Voting Securities" means the outstanding securities entitled to vote generally in the election of directors or other governing body.

As used in this Agreement, unless the context otherwise expressly requires to the contrary, references to the singular include the plural, and vice versa; references to the masculine include the feminine and neuter; references to "including" mean "including (without limitation)"; and references to Sections and clauses mean the sections and clauses of this Agreement.

2. Term of Agreement. The Term of this Agreement shall commence on the Effective Date and ending on (a) the last day of the three-year period beginning on the Effective Date if no Change in Control shall have occurred during that three-year period (such last day being the "Expiration Date"); or (b) if a Change in Control shall have occurred during (i) the three-year period beginning on the Effective Date or (ii) any period for which the Term of this Agreement shall have been automatically extended pursuant to the second sentence of this Section, the last day of the two-year period beginning on the date on which the Change in Control occurred.

Provided that after the expiration of the time period described in subsection (a) of this Section and in the absence of a Change in Control (as described in subsection (b) of this Section) the Term of the Agreement shall be automatically extended for successive two-year periods beginning on the day immediately following the Expiration Date (the beginning date of each successive two-year period being a "Renewal Date"), unless, not later than 18 months prior to the Expiration Date or applicable Renewal Date, the Company shall give notice to Executive that the Term of the Agreement will not be extended.

3. Compensation Other Than Severance Payments.

3.1 Equity Based Compensation. Upon the occurrence of a Change in Control, all options to acquire Baker Hughes stock, all shares of restricted Baker Hughes stock, all other equity or phantom equity incentives and any awards the value of which is determined by reference to or based upon the value of Baker Hughes stock, held by the Executive under any plan of the Company shall become immediately vested, exercisable and nonforfeitable and all conditions thereof (including, but not limited to, any required holding periods) shall be deemed to have been satisfied.

3.2 Compensation and Benefits During Incapacity and Prior to Termination of Employment. Following a Change in Control and during the Term of this Agreement, during any period in which the Executive fails to perform the Executive's full-time duties with the Company as a result of incapacity due to physical or mental illness, the Company shall pay the Executive's full salary to the Executive at the rate in effect at the commencement of any such period, together with all compensation and benefits payable to the Executive under the terms of any compensation or benefit plan, program or arrangement maintained by the Company during such period, until the Executive's employment is terminated by the Company for Disability.

3.3 Benefits Following Termination of Employment. If Executive incurs a Termination of Employment during the Term of this Agreement, the Company shall provide the Executive the benefits described below.

(a) Severance Payment Based Upon Base Compensation. The Company will pay the Executive a cash severance benefit equal to three times the Executive's Highest Base Compensation. An Executive's severance payment under this paragraph (a) will be paid in accordance with the provisions of Section 4.

(b) Severance Payment Based Upon Bonuses. The Company will pay the Executive a cash severance benefit in an amount equal to the sum of (1) and (2) where (1) is an amount equal to the product of (A) the expected value target percentage under the Executive's Bonus for the Baker Hughes' fiscal year in which the Executive's Termination of Employment occurs, (B) the Executive's Highest Base Compensation and (C) a fraction, the numerator of which is the number of full months and any fractional portion of a month during the performance period through the Executive's Employment Termination Date and the denominator of which is the total number of months during such performance period; and (2) is an amount equal to the product of (A) the expected value target percentage under the Executive's Bonus for the Baker Hughes' fiscal year in which the Executive's Termination of Employment occurs, and (B) three times the Executive's Highest Base Compensation. However, if the Executive's Employment Termination Date occurs during the same calendar year in which a Change in Control occurs, the pro-rata bonus payment described in clause (1) of the preceding sentence shall be offset by any payments received by the

Executive under the Baker Hughes Incorporated 1995 Employee Annual Incentive Compensation Plan (as amended and/or restated) in connection with the Change in Control. An Executive's severance payment under this paragraph (b) will be paid in accordance with the provisions of Section 4.

(c) Outplacement. The Company will provide the Executive outplacement services suitable to the Executive's position for the period of three years. In lieu of such outplacement services, if the Executive so elects, the Company shall pay the Executive $30,000.00 in cash. Any such cash payment in lieu of outplacement services will be paid in accordance with the provisions of Section 4.

(d) Pension, Thrift and Supplemental Retirement Plans. In addition to the retirement benefits to which the Executive is entitled under the Thrift Plan, the Pension Plan and the Supplemental Retirement Plan, the Company shall pay the Executive a single sum cash payment in an amount equal to the undiscounted value of (A) the employer-provided accruals under the Pension Plan that the Executive would have earned and (B) the employer contributions the Company would have made to the Thrift Plan and the Supplemental Retirement Plan (including but not limited to matching and base contributions) on behalf of the Executive had the Executive continued in the employ of the Company for a period of three years after the Employment Termination Date. Assuming for this purpose that (i) the Executive's earned compensation per year during that three year period of time is the sum of (1) the Executive's Highest Base Compensation and (2) the product of (A) the expected value target percentage under the Executive's Bonus for the Baker Hughes' fiscal year in which the Executive's Termination of Employment occurs, and (B) the Executive's Highest Base Compensation; and (ii) contribution, deferral, credit and accrual percentages made under the Pension Plan, the Thrift Plan and the Supplemental Retirement Plan, by and on behalf of the Executive during the three year period, are the same percentages in effect on the date of the Change in Control or the Executive's Employment Termination Date, whichever is more favorable for the Executive. The payment required under this paragraph (d) will be made in accordance with the provisions of Section 4.

(e) Accident and Health Insurance Benefits. For three years following the Executive's Employment Termination Date (the "Continuation Period"), the Company shall arrange to provide the Executive and his dependents accident and health insurance benefits, in each case, substantially similar to those provided to the Executive and his dependents immediately prior to the Employment Termination Date or, if more favorable to the Executive, those provided to the Executive and his dependents immediately prior to the first occurrence of an event or circumstance constituting Good Reason, at no greater cost to the Executive than the cost to the Executive immediately prior to such date or occurrence. Benefits otherwise receivable by the Executive pursuant to this Section 3.3(e) shall be reduced to the extent benefits of the same type are received by or made available to the Executive during the Continuation Period (and any such benefits received by or made available to the Executive shall be reported to the Company by the Executive); provided, however, that the Company shall reimburse the Executive for the excess, if any, of the cost of such benefits to the Executive over such cost immediately prior to the Employment Termination Date or, if more favorable to the Executive, the first occurrence of an event or circumstance constituting Good Reason.

(f) Life Insurance. Executive shall be entitled to a single sum cash payment in an amount equivalent to thirty-six (36) monthly basic life insurance premiums applicable to the Executive's basic life insurance coverage on his Employment Termination Date. The single sum cash payment will be made in accordance with the provisions of Section 4. An Executive may, at his option, convert his basic life insurance coverage to an individual policy after his Employment Termination Date by completing the forms required by the Company.

(g) Perquisites. Executive shall be entitled to a single sum cash payment which shall be an amount equal to the sum of (1) the cost of the Executive's Perquisites in effect prior to his Termination of Employment for the remainder of the calendar year in which the Employment Termination Date occurs; plus (2) the cost of the Executive's Perquisites in effect prior to his Termination of Employment for an additional three years. The payment required under this paragraph (g) will be made in accordance with the provisions of Section 4. An Executive may, at his option, purchase any of his club memberships held in the Company's name for fair market value and on the terms mutually agreed by the Executive and the Committee.

(h) Retiree Medical. If the Executive would have become entitled to benefits under the Company's post-retirement health care insurance plans, as in effect immediately prior to the Employment Termination Date or, if more favorable to the Executive as in effect immediately prior to the first occurrence of an event or circumstance constituting Good Reason, had the Executive's employment terminated at any time during the period of thirty-six (36) months after the Employment Termination Date, the Company shall provide such post-retirement health care insurance benefits to the Executive and the Executive's dependents commencing on the later of (i) the date on which such coverage would have first become available and (ii) the date on which the applicable benefits described in paragraph (e) of this Section terminate.

3.4 Gross-Up Payments. If any payments or benefits received or to be received by the Executive (whether pursuant to the terms of this Agreement, or any other plan or agreement with the Company, any Person whose actions result in a Change in Control or any Person affiliated with the Company or such Person) (such payments or benefits, excluding the Gross-Up Payment, being hereinafter referred to as the "Total Payments") will be subject to the Excise Tax, the Company shall pay the Executive an additional amount (the "Gross-Up Payment") such that the net amount retained by the Executive after the deduction of any Excise Tax on the Total Payments and any federal, state and local income and employment taxes and Excise Tax upon the Gross-Up Payment shall be equal to the Total Payments. The purpose of this Section is to place the Executive in the same economic position such Executive would have been in had no Excise Tax been imposed with respect to the Total Payments.

(a) For purposes of determining whether any of the Total Payments will be subject to the Excise Tax and the amount of such Excise Tax, (i) all of the Total Payments shall be treated as "parachute payments" (within the meaning of section 280G(b)(2) of the Code) unless, in the opinion of tax counsel (the "Tax Counsel") reasonably acceptable to the Executive and selected by the accounting firm which was, immediately prior to the Change in Control, the Company's independent auditor (the "Auditor"), such payments or benefits (in whole or in part) do not constitute parachute payments, including by reason of section 280G(b)(4)(A) of the Code, (ii) all "excess parachute payments" within the meaning of section 280G(b)(l) of the Code shall be treated as subject to the Excise Tax unless, in the opinion of the Tax Counsel, such excess parachute payments (in whole or in part) represent reasonable compensation for services actually rendered (within the meaning of section 280G(b)(4)(B) of the Code) in excess of the “base amount” (within the meaning of section 280G(b)(3) of the Code) allocable to such reasonable compensation, or are otherwise not subject to the Excise Tax, and (iii) the value of any noncash benefits or any deferred payment or benefit shall be determined by the Auditor in accordance with the principles of sections 280G(d)(3) and (4) of the Code.

(b) For purposes of determining the amount of the Gross-Up Payment, the Executive shall be deemed to pay federal income tax at the highest marginal rate of federal income taxation in the calendar year in which the Gross-Up Payment is to be made and state and local income taxes at the highest marginal rate of taxation in the state and locality of the Executive’s residence on the Employment Termination Date (or if there is no Employment Termination Date, then the date on which the Gross-Up Payment is calculated for purposes of this Section), net of the maximum reduction in federal income taxes which could be obtained from deduction of such state and local taxes.

(c) In the event that the Excise Tax is finally determined to be less than the amount taken into account hereunder in calculating the Gross-Up Payment, the Executive shall repay to the Company, within ten (10) business days following the time that the amount of such reduction in the Excise Tax is finally determined, the portion of the Gross-Up Payment attributable to such reduction (plus that portion of the Gross-Up Payment attributable to the Excise Tax and federal, state and local income and employment taxes imposed on the Gross-Up Payment benefit being repaid by the Executive, to the extent that such repayment results in a reduction in the Excise Tax and a dollar-for-dollar reduction in the Executive’s taxable income and wages for purposes of federal, state and local income and employment taxes), plus interest on the amount of such repayment at 120 percent of the rate provided in section 1274(b)(2)(B) of the Code. In the event that the Excise Tax is determined to exceed the amount taken into account hereunder in calculating the Gross-Up Payment (including by reason of any payment the existence or amount of which cannot be determined at the time of the payment of the Gross-Up Payment), the Company shall make an additional Gross-Up Payment in respect of such excess (plus any interest, penalties or additions payable by the Executive with respect to such excess) within five (5) business days following the time that the amount of such excess is finally determined. The Executive and the Company shall each reasonably cooperate with the other relative to any administrative or judicial proceedings concerning the existence or amount of liability for the Excise Tax.

3.5 Legal Fees. The Company shall pay, on a fully grossed up, after tax basis, all legal fees and expenses incurred by the Executive (i) in disputing in good faith any issue relating to the Executive’s termination of employment, (ii) in seeking in good faith to obtain or enforce any benefit or right provided under this Agreement in accordance with Section 5.3, or (iii) in connection with any tax audit or proceeding to the extent attributable to the application of section 4999 of the Code to any payment or benefit under this Agreement. Such payments shall be made within ten (10) business days after delivery of the Executive’s written request for payment accompanied with such evidence of fees and expenses incurred as the Company may reasonably require.

4. Time of Benefits Payments. The Company shall pay the Executive any cash benefits described in paragraphs (a), (b), (c) (if the Executive elects to receive a cash payment in lieu of outplacement services), (d), (e) and (f) of Section 3.3 in a single sum cash payment within thirty (30) days after the Executive's Employment Termination Date. If it is subsequently determined that additional monies are due and payable to the Executive as benefits described in paragraphs (a), (b), (c) (if the Executive elects to receive a cash payment in lieu of outplacement services), (d) and (f) of Section 3.3, the Company will pay any such unpaid benefits to the Executive, together with interest on the unpaid benefits from the date the single sum cash payment was made at the annual rate of 120 percent of the rate provided in section 1274(b)(2)(B) of the Code, within ten (10) business days of discovering that the additional monies are due and payable. If the benefits paid to the Executive are subsequently determined to exceed the amount of benefits the Executive should have received, such excess shall constitute a loan by the Company to the Executive, payable within ten (10) business days after demand by the Company, together with interest from the date the single sum cash payment was made at the annual rate of 120 percent of the rate provided in section 1274(b)(2)(B) of the Code, but only to the extent such amount has not been previously paid by the Executive.

5. Termination Procedures And Compensation During Dispute.

5.1 Notice of Termination. After a Change in Control and during the Term of this Agreement, any purported termination of the Executive's employment by the Company shall be communicated by the Company by a written Notice of Termination to the Executive in accordance with Section 9.8 hereof. For purposes of this Agreement, a "Notice of Termination" shall mean a notice which shall indicate the specific termination provision in this Agreement relied upon and shall set forth in reasonable detail the facts and circumstances claimed to provide a basis for termination of the Executive's employment under the provision so indicated. Further, a Notice of Termination for Cause is required to include a copy of a resolution duly adopted by the affirmative vote of not less than three-quarters (3/4) of the entire membership of the Board at a meeting of the Board which was called and held for the purpose of considering such termination (after reasonable notice to the Executive and an opportunity for the Executive, together with the Executive's counsel, to be heard before the Board) finding that, in the good faith opinion of the Board, the Executive was guilty of conduct set forth in clause (i) or (ii) of the definition of Cause herein, and specifying the particulars thereof in detail. No purported termination of the Executive's employment by the Company after a Change in Control and during the Term of this Agreement shall be effective unless the Company complies with the procedures set forth in this Section.

5.2 Employment Termination Date. "Employment Termination Date," with respect to any purported termination of the Executive's employment after a Change in Control and during the Term of this Agreement, shall mean (i) if the Executive's employment is terminated for Disability, thirty (30) days after Notice of Termination is given (provided that the Executive shall not have returned to the full-time performance of the Executive's duties during such thirty (30) day period), and (ii) if the Executive's employment is terminated for any other reason, the date specified in the Notice of Termination (which, in the case of a termination by the Company, shall not be less than thirty (30) days (except in the case of a termination for Cause) and, in the case of a termination by the Executive, shall not be less than fifteen (15) days nor more than sixty (60) days, respectively, from the date such Notice of Termination is given).

5.3 Dispute Concerning Termination. If within fifteen (15) days after any Notice of Termination is given, or, if later, prior to the Employment Termination Date (as determined without regard to this Section), the party receiving such Notice of Termination notifies the other party that a dispute exists concerning the termination, the Employment Termination Date shall be extended until the earlier of (i) the date on which the Term of this Agreement ends or (ii) the date on which the dispute is finally resolved, either by mutual written agreement of the parties or by a final judgment, order or decree of an arbitrator or a court of competent jurisdiction (which is not appealable or with respect to which the time for appeal therefrom has expired and no appeal has been perfected); provided, however, that the Employment Termination Date shall be extended by a notice of dispute given by the Executive only if such notice is given in good faith and the Executive pursues the resolution of such dispute with reasonable diligence.

5.4 Compensation During Dispute. If a purported termination occurs following a Change in Control and during the Term of this Agreement and the Employment Termination Date is extended in accordance with Section 5.3 hereof, the Company shall continue to pay the Executive the full compensation in effect when the notice giving rise to the dispute was given (including, but not limited to, salary) and continue the Executive as a Executive in all compensation, benefit and insurance plans in which the Executive was participating when the notice giving rise to the dispute was given or those plans in which the Executive was participating immediately prior to the first occurrence of an event or circumstance giving rise to the Notice of Termination, if more favorable to the Executive, until the Employment Termination Date, as determined in accordance with Section 5.3 hereof. Amounts paid under this Section are in addition to all other amounts due under this Agreement (other than those due under Section 3.2 hereof) and shall not be offset against or reduce any other amounts due under this Agreement.

6. Withholding. Subject to the provisions of Section 3.4, Company may withhold from any benefits paid under this Agreement all income, employment, and other taxes required to be withheld under applicable law.

7. Death of Executive. If an Executive dies after his Employment Termination Date but before the Executive receives full payment of the benefits to which he is entitled, any unpaid benefits will be paid to the Executive’s surviving spouse, or if the Executive does not have a surviving spouse, to the Executive’s estate.

8. Amendment and Termination. During the Term of this Agreement, this Agreement may not be terminated or amended in any manner that would negatively affect a Executive’s rights under this Agreement. Further, no amendment or termination of this Agreement after a Executive’s Employment Termination Date shall affect the benefits payable to such Executive. Subject to the foregoing restrictions, Baker Hughes may amend or terminate this Agreement by a written instrument that is authorized by the Committee.

9. Miscellaneous.

9.1 Agreement Not an Employment Contract. The adoption and maintenance of this Agreement is not an employment contract between the Company and Executive and gives Executive no right to retain his employment. It is not intended to interfere with the rights of the Company to terminate Executive's employment at any time with or without notice and with or without cause or to interfere with an Executive's right to terminate his employment at any time.

9.2 Alienation Prohibited. No benefits hereunder shall be subject to anticipation or assignment by Executive, to attachment by, interference with, or control of any creditor of Executive, or to being taken or reached by any legal or equitable process in satisfaction of any debt or liability of Executive prior to its actual receipt by Executive. Any attempted conveyance, transfer, assignment, mortgage, pledge, or encumbrance of the benefits hereunder prior to payment thereof shall be void.

9.3 Severability. Each provision of this Agreement may be severed. If any provision is determined to be invalid or unenforceable, that determination shall not affect the validity or enforceability of any other provision.

9.4 Binding Effect. This Agreement shall be binding upon any successor of the Company. Further, the Board shall not authorize a Change in Control that is a merger or a sale transaction unless the purchaser or the Company's successor agrees to take such actions as are necessary to cause Executive to be paid or provided all benefits due under the terms of this Agreement as in effect immediately prior to the Change in Control.

9.5 Settlement of Disputes Concerning Benefits Under this Agreement; Arbitration. All claims by Executive for benefits under this Agreement shall be directed to and determined by the Committee and shall be in writing. Any denial by the Committee of a claim for benefits under this Agreement shall be delivered to the Executive in writing within thirty (30) days after written notice of the claim is provided to the Company in accordance with Section 9.8 and shall set forth the specific reasons for the denial and the specific provisions of this Agreement relied upon. The Committee shall afford a reasonable opportunity to the Executive for a review of the decision denying a claim and shall further allow the Executive to appeal to the Committee a decision of the Committee within sixty (60) days after notification by the Committee that the Executive's claim has been denied. Any further dispute or controversy arising out of or relating to this Agreement, including without limitation, any and all disputes, claims (whether in tort, contract, statutory or otherwise) or disagreements concerning the interpretation or application of the provisions of this Agreement shall be resolved by arbitration in accordance with the rules of the American Arbitration Association (the "AAA") then in effect. No arbitration proceeding relating to this Agreement may be initiated by either the Company or the Executive unless the claims review and appeals procedures specified in Section 5.3 have been exhausted. Within ten (10) business days of the initiation of an arbitration hereunder, the Company and the Executive will each separately designate an arbitrator, and within twenty (20) business days of selection, the appointed arbitrators will appoint a neutral arbitrator from the AAA Panel of Commercial Arbitrators. The arbitrators shall issue their written decision (including a statement of finding of facts) within thirty (30) days from the date of the close of the arbitration hearing. The decision of the arbitrators selected hereunder will be final and binding on both parties. This arbitration provision is expressly made pursuant to and shall be governed by the Federal Arbitration Act, 9 U.S.C. Sections 1-16 (or replacement or successor statute). Pursuant to Section 9 of the Federal Arbitration Act, the Company and any Executive agree that a judgment of the United States District Court for the District in which the headquarters of Baker Hughes is located at the time of initiation of an arbitration hereunder may be entered upon the award made pursuant to the arbitration.

9.6 No Mitigation. The Company agrees that if the Executive's employment with the Company terminates during the Term of this Agreement, the Executive is not required to seek other employment or to attempt in any way to reduce any amounts payable to the Executive by the Company pursuant to this Agreement. Further, except as expressly provided otherwise herein, the amount of any payment or benefit provided for in this Agreement (other than Section 3.3(e) hereof) shall not be reduced by any compensation earned by the Executive as the result of employment by another employer, by retirement benefits, by offset against any amount claimed to be owed by the Executive to the Company, or otherwise.

9.7 Other Amounts Due. Except as expressly provided otherwise herein, the payments and benefits provided for in this Agreement are in addition to and not in lieu of amounts and benefits that are earned by an Executive prior to his Termination of Employment. The Company shall pay an Executive any compensation earned through the Employment Termination Date but not previously paid the Executive. Further the Executive shall be entitled to any other amounts or benefits due the Executive in accordance with any contract, plan, program or policy of the Company or any of its Affiliates. Amounts that the Executive is entitled to receive under any plan, program, contract or policy of the Company or any of its Affiliates at or subsequent to the Executive's Termination of Employment shall be payable or otherwise provided in accordance with such plan, program, contract or policy, except as expressly modified herein.

9.8 Notices. For the purpose of this Agreement, notices and all other communications provided for in this Agreement shall be in writing and shall be deemed to have been duly given when delivered or mailed by United States registered mail, return receipt requested, postage prepaid, addressed, if to the Executive, to the address listed on the signature page of this Agreement and, if to the Company, to 3900 Essex Lane; Houston, Texas 77027; Attention: General Counsel, or to such other address as either party may have furnished to the other in writing in accordance herewith, except that notice of change of address shall be effective only upon actual receipt.

9.9 Governing Law. All provisions of this Agreement shall be construed in accordance with the laws of Texas, except to the extent preempted by federal law and except to the extent that the conflicts of laws provisions of the State of Texas would require the application of the relevant law of another jurisdiction, in which event the relevant law of the State of Texas will nonetheless apply, with venue for litigation being in Houston, Texas.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the date above first written.

BAKER HUGHES INCORPORATED

By: ______________________________

Michael E. Wiley
Chairman and Chief Executive Officer

EXECUTIVE:

____

______________________________, Executive

Address:

____

____

Exhibit 31.1

CERTIFICATION

I, Chad C. Deaton, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Baker Hughes Incorporated;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) [INTENTIONALLY OMITTED PURSUANT TO SEC RELEASE NO. 33-8238 AND 34-47986];

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 3, 2004

By: /s/ Chad C. Deaton

Chad C. Deaton
Chairman of the Board and
Chief Executive Officer

Exhibit 31.2

CERTIFICATION

I, G. Stephen Finley, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Baker Hughes Incorporated;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) [INTENTIONALLY OMITTED PURSUANT TO SEC RELEASE NO. 33-8238 AND 34-47986];

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 3, 2004

By: /s/ G. Stephen Finley

G. Stephen Finley
Sr. Vice President – Finance and
Administration and Chief Financial Officer

Exhibit 32

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Baker Hughes Incorporated (the "Company") on Form 10-Q for the period ended September 30, 2004, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Chad C. Deaton, Chief Executive Officer of the Company, and G. Stephen Finley, the Chief Financial Officer of the Company, each of the undersigned hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(i) The Report fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and

(ii) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

The certification is given to the knowledge of the undersigned.

/s/ Chad C. Deaton

Name: Chad C. Deaton
Title: Chief Executive Officer
Date: November 3, 2004

/s/ G. Stephen Finley

Name: G. Stephen Finley
Title: Chief Financial Officer
Date: November 3, 2004