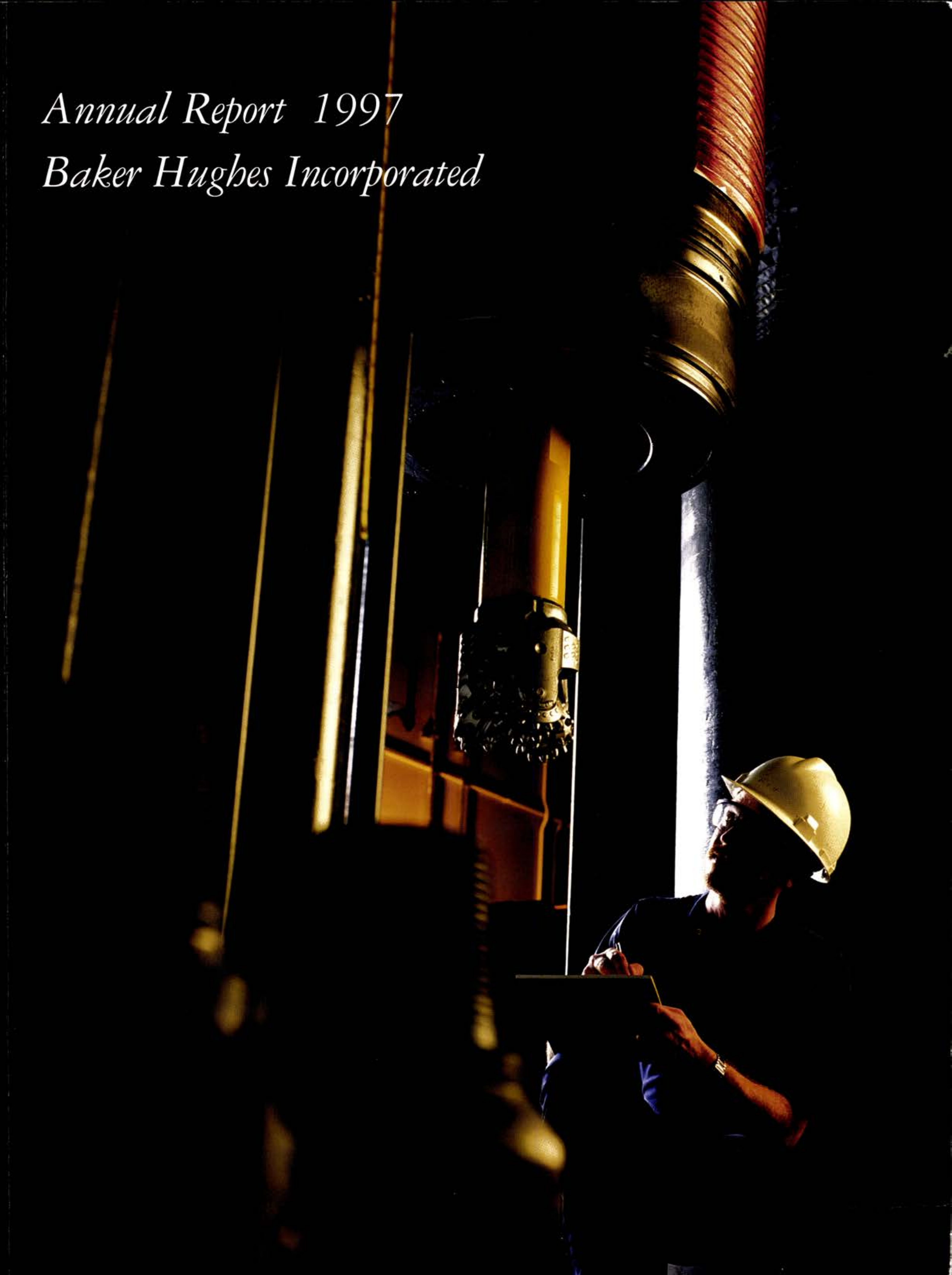
Annual Report 1997
Baker Hughes Incorporated



Baker Hughes is a leader in the worldwide petroleum and continuous process industries.

OILFIELD

Baker Hughes Oilfield Operations is comprised of five companies.

Baker Hughes Solutions combines Baker Hughes technology into integrated solutions and helps clients develop opportunities in mature fields and emerging markets.

Baker Hughes INTEQ is a leading supplier of directional drilling, measurement-while-drilling, drilling fluids and wellsite information management services.

Baker Oil Tools is a world leader in completion, workover and fishing technologies.

Hughes Christensen is a leading supplier of roller cone and PDC drill bit technology.

Centrilift is a leading provider of electric submersible pump systems.

CHEMICALS

Baker Petrolite: is a leading specialty chemical supplier to the petroleum production, transportation and refining industries.

PROCESS EQUIPMENT

Baker Hughes Process Equipment Company serves the worldwide process industries through three companies.

EIMCO Process Equipment supplies equipment and technology for physical separation and biological treatment processes in water and wastewater treatment as well as in a variety of industrial production processes.

Bird Machine Company manufactures a broad range of high quality, precision engineered equipment for liquid/solid separation.

Baker Hughes Process Systems provides the oil and gas industry a single source for advanced hydrocyclone technology, separation systems, water injection packages and anti-biofouling systems.

1997 HIGHLIGHTS

- Completed transfer of leadership to Max L. Lukens as Chairman, President and CEO of Baker Hughes Incorporated.
- Created Baker Hughes Solutions to focus on the evolving integrated solutions market.
- Acquired Petrolite Corporation and formed Baker Petrolite.
- Named Andrew J. Szescila president of Baker Hughes Oilfield Operations.
- Initiated Project Renaissance, a four-year business process redesign effort.
- Consolidated all Baker Hughes completions businesses into Baker Oil Tools.
- Introduced new products including the AutoTrak rotary closed loop drilling system.
- Commercialized the Galileo Reeled System Technology.
- Acquired Drilex, strengthening land-based directional drilling operations at Baker Hughes INTEQ.
- Acquired the Environmental Technology Division of Deutz AG to strengthen our position in liquid/solid separation.

On the Cover: An engineer at Hughes Christensen checks a new HydraBoss tricone bit before running it in the company's simulator, which tests drilling performance under downhole conditions.

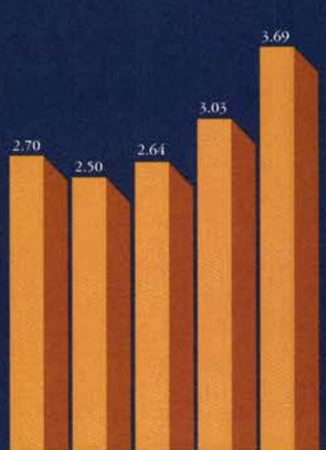
SELECTED FINANCIAL HIGHLIGHTS

(In millions, except per share amounts)

Year ended September 30,	1997	1996	1995
Revenues	$3,685.4	$3,027.7	$2,637.5
Operating income	259.9	306.7	255.9
Income before cumulative effect of accounting changes	109.1	176.4	120.0
Net income	97.0	176.4	105.4
Income per share before cumulative effect of accounting changes	.71	1.23	.67
Net income per share	.63	1.23	.57
Working capital	1,284.2	1,081.1	984.7
Total assets	4,756.3	3,297.4	3,166.6
Long-term debt	771.8	673.6	798.4
Stockholders' equity	2,604.6	1,689.2	1,513.5
Debt/equity ratio	.30	.40	.53
Number of shares:			
Outstanding at year end	169.1	144.5	142.2
Average during year	153.1	143.3	141.2
Number of employees (thousands)	21.2	16.8	15.2

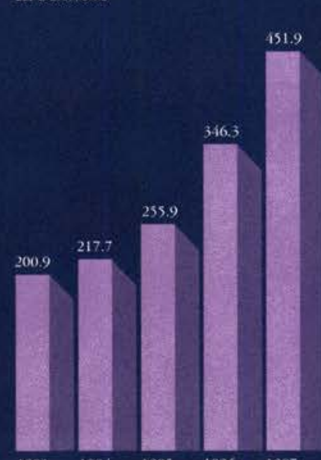
REVENUES

In Billions



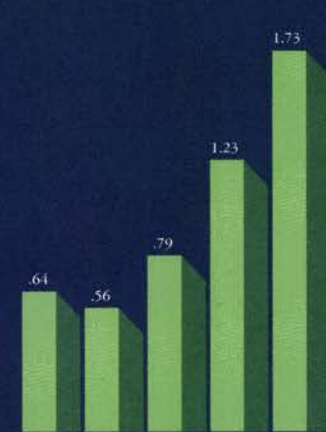
OPERATING INCOME*

In Millions

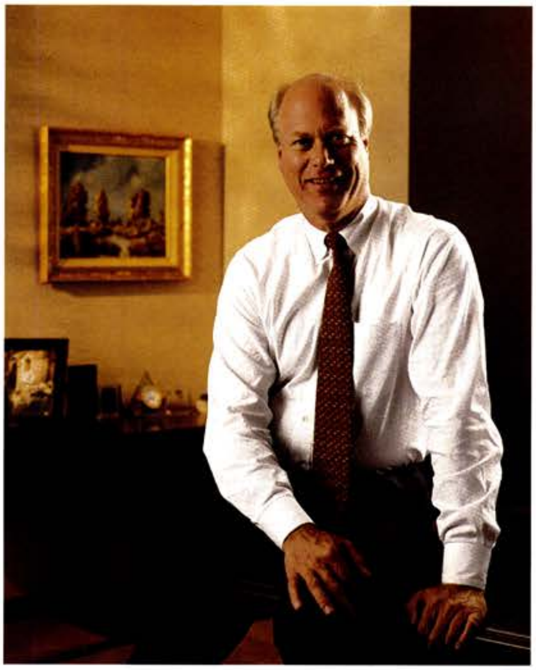


EARNINGS PER SHARE*

In Dollars



* excludes unusual and nonrecurring items



MAX L. LUKENS
CHAIRMAN, PRESIDENT
AND CHIEF EXECUTIVE OFFICER

1997 was a year of both success and change for Baker Hughes as well as for me personally. I had the distinct honor of taking the reins of Baker Hughes in October of 1996 upon the retirement of Jim Woods. I feel extremely fortunate to be leading Baker Hughes at a time when the fundamental drivers of our industry are the best they have been in fifteen years. In 1997, we achieved record growth with 41% increase in operating earnings per share. We also set a new strategic direction to ensure our long-term competitiveness in the oilfield service industry.

Our first strategic move was to transfer our sand control product line from Baker Hughes INTEQ to Baker Oil Tools.

At the same time, we separated our integrated solutions business from INTEQ and established it as its own business operating as our Baker Hughes Solutions division. This left INTEQ to focus on drilling products and solutions, and gave Baker Oil Tools a comprehensive offering in well completions technology. These steps should maximize BHI's growth, strengthen our competitiveness, and foster the changes required to achieve our growth objectives.

Competitive Position

BHI reinforced its competitive position through four key acquisitions.

In July, we acquired Petrolite Corporation in a stock-for-stock transaction that moved us into a leading worldwide position in the oilfield specialty chemical business.

Also in July, we acquired Drilex International Inc. in a stock transaction that strengthened our presence in the growing U.S. onshore directional drilling business

After the close of our fiscal year we acquired ODI, Inc., an electrical submersible pump company, which reinforced our leadership position in this important, production-related market sector.

These acquisitions complement our existing competitive position and give us one of the strongest group of oilfield product lines in the industry. Baker Hughes is a leader in twelve of its thirteen major product offerings. During the year, we introduced new technology – including advanced drill bits, automated drilling systems, multilateral completions, and downhole oil/water separation systems – that reduce costs and increase productivity for our clients.

With these product lines and Baker Hughes Solutions' project management expertise, we now serve our customers over the entire hydrocarbon life cycle, including exploration, development, and production. We believe that this strategic positioning will enable us to capitalize on the increasingly attractive opportunites in the oilfield service business over the next several years.

Also in July, we purchased the Environmental Technology Division of Deutz AG, adding to our separation technology business at Baker Hughes Process Equipment Company. Our plan for this segment is to grow revenues and profits through continued geographic and technological expansion. We expect our base business to grow significantly with an improving world economy, and we will continue to make acquisitions in this segment over the next few years.

Changes to Enable Growth

To enable this rapid growth, we have begun to review, evaluate and improve our business processes in a company-wide effort named Project Renaissance. This initiative will cost over $200 million over the next 4 years. BHI has quantified and targeted annual recurring cost savings in excess of $100 million. I believe that this project is one of the most important in BHI's history.

Organization

In July, Andrew J. Szescila was appointed President of Baker Hughes Oilfield Operations comprised of Baker Oil Tools, Baker Hughes INTEQ, Baker Hughes Solutions, Centrilift, and Hughes Christensen Company. This organizational change will help BHI compete on an enterprise-wide basis. It will also facilitate multi-company research projects, while optimizing our product line strengths and our leadership in integrated solutions.

Our View of the Future

We believe that – with demand for oil and gas increasing at 2-1/2% - 4% per year – our customers will increase capital spending at double-digit percentage rates for the next several years.

With relatively flat oil prices forecasted in the near term, our customers will continue to demand technological solutions to reduce costs and increase reserves and production. Increasingly, BHI's full range of technology and services will help oil companies meet these objectives throughout the lives of their assets from exploration through final production.

Director Changes

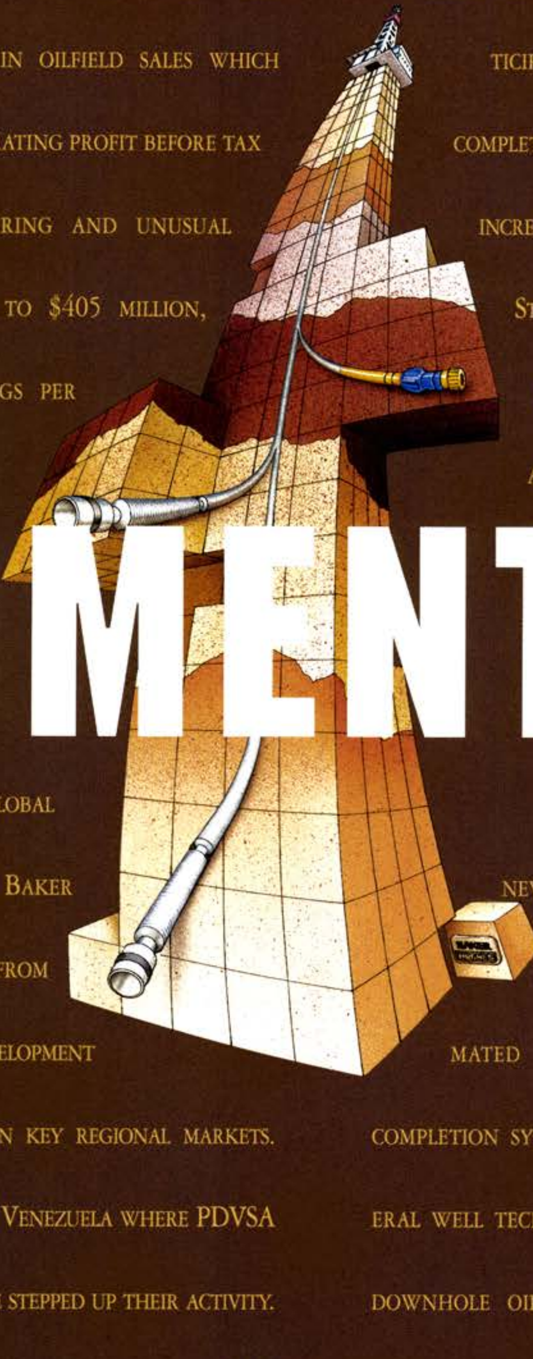
Two of our directors, Jack Blanton and Don Trauscht, complete their tenure with the Board this year. We have appreciated their steady and valued guidance over the past decade.

Baker Hughes employed more than 21,000 people at our fiscal year end. Their talents, service to the customer, and desire to add value are critical to BHI's ongoing success. We thank them for their continuing efforts.

Max L. Lukens

Max L. Lukens
Chairman, President and Chief Executive Officer

In a strong market, Baker Hughes achieved significant growth in 1997. Revenues reached a record \$3.7 billion, a 22% increase from 1996. Gains were paced by 19% growth in oilfield sales which reached \$2.9 billion. Operating profit before tax (exclusive of nonrecurring and unusual charges) grew by 38% to \$405 million, while operating earnings per share grew by 41%.



MOMENTUM

Our extensive global infrastructure enabled Baker Hughes to benefit from increased exploration, development and production activity in key regional markets. Revenues increased 53% in Venezuela where PDVSA and foreign operators have stepped up their activity. In Canada, Baker Hughes revenues were up 24% based on a leading position in horizontal drilling. In Norway, Baker Hughes was awarded two important long-term completions technology contracts helping boost revenues by 20% and promising significant future growth. In the Middle East, strong participation in renewed drilling and completion activity produced a revenue increase of 33%. Revenues in the United States increased by 26%, based on our strong presence in the Gulf of Mexico and a resurgence of onshore activity.

Baker Hughes introduced many new products in 1997. These include new drill bit technology, an automated drilling system, intelligent completion systems, and new levels of multilateral well technology. Ongoing developments in downhole oil/water separation, coiled tubing drilling, and measurement-while-drilling position the company to share in the value we deliver to our clients.

FOR GROWTH

Baker Hughes capital expenditures, primarily for field equipment, were $343 million in 1997 almost double capital spending in 1996. Our aggressive investment will continue as we exploit geographic and new product opportunities.

Including acquisitions, Baker Hughes added over 4,000 employees during the year, primarily in marketing, field operations and manufacturing. Training and personnel development efforts have been increased substantially.

During the third quarter of 1997, Baker Hughes launched Project Renaissance, an enterprise-wide effort to optimize business processes throughout the company, using SAP R/3 as its software solution. With expected completion in 2001, Project Renaissance has quantified and targeted over $100 million in annual recurring savings.

In 1997, we made several acquisitions that will make us more competitive in the oilfield, chemical and continuous process industries. Most significantly, the Petrolite Corporation was purchased in a stock for stock transaction and combined with Baker Performance Chemicals Inc. to form Baker Petrolite. With revenues in excess of $700 million, this new division is a leading provider to the oilfield chemical market.

We also are building on our experience as the pioneer in integrated solutions to create opportunities for our customers and ourselves in both mature fields and emerging markets. Baker Hughes Solutions will pursue innovative business arrangements involving project financing , and is expected to achieve significant growth in Venezuela and the Caspian Sea region.

Baker Hughes is investing for growth, in technology, equipment and people.

Drilling motor components at Baker Hughes INTEQ's manufacturing facility in Celle, Germany

DRIVING GROWTH

Our growth is being driven and sustained by many factors. Energy companies continue to increase their capital spending, both to reverse production declines in older fields and to develop reserves in new areas.

Our experienced management team has new leadership that combines financial and operations expertise to identify and exploit growth opportunities.

New technology — from virtually every Baker Hughes division— is improving the economics of producing oil and gas and making us an ever more valuable partner with our clients.

In a global market, the company's worldwide distribution network lets us participate in growing regional markets. Our leadership position in major product lines enable us to grow even in relatively mature areas.

We have invested significantly in research at our R&D centers, new capacity at our manufacturing plants, more equipment for our rental tool fleets, and in qualified people for our field service operations.

Renewed emphasis on improved business practices has taken shape as Project Renaissance, an enterprise-wide effort that will enable us to effectively exploit opportunities for growth.

WORLDWIDE COVERAGE HAS ENABLED BAKER HUGHES TO MAKE SIGNIFICANT GAINS IN GROWTH AREAS LIKE EASTERN AND WESTERN VENEZUELA, NORWAY, WEST AFRICA, THE MIDDLE EAST, MEDITERRANEAN, CANADA, AND THE DEEPWATER AREAS OF THE GULF OF MEXICO.

Project Renaissance

BAKER HUGHES HAS LAUNCHED PROJECT RENAISSANCE TO OPTIMIZE EVERY MAJOR BUSINESS PROCESS IN THE COMPANY. USING SAP R/3 AS ITS SOFTWARE SOLUTION, THE PROJECT TEAM WILL REENGINEER ORDER ENTRY, MANUFACTURING, DISTRIBUTION, BILLING, COLLECTION AND OTHER PROCESSES. $100 MILLION IN RECURRING ANNUAL SAVINGS HAVE BEEN QUANTIFIED AND TARGETED UPON THE COMPLETION OF THE PROJECT.

TO SUPPLY A GROWING MARKET IN VENEZUELA, BAKER HUGHES INTEQ RECENTLY COMMISSIONED A 9800-BARREL DRILLING FLUIDS BARGE, THE LARGEST UNIT ON LAKE MARACAIBO.

MAX LUKENS (RIGHT) BECAME CHAIRMAN, PRESIDENT AND CEO IN JANUARY 1997 AND SOON INITIATED A NEW STRATEGIC DIRECTION. IN HIS NEW ROLE AS PRESIDENT OF THE OILFIELD OPERATIONS GROUP, ANDY SZESCILA (LEFT) WILL ASSURE THAT BAKER HUGHES COMPETES AS A SINGLE OILFIELD COMPANY ON AN ENTERPRISE-WIDE BASIS.

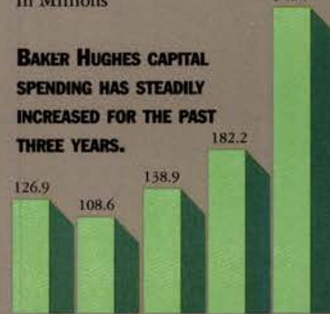
Hughes Christensen posted record revenues and margins in 1997, with manufacturing at its Woodlands, Texas facility producing both Tricone and PDC drill bits at near full capacity.

Training activity, like this drilling fluid engineer class at Baker Hughes INTEQ, has increased significantly to improve the skills of both experienced and new employees.

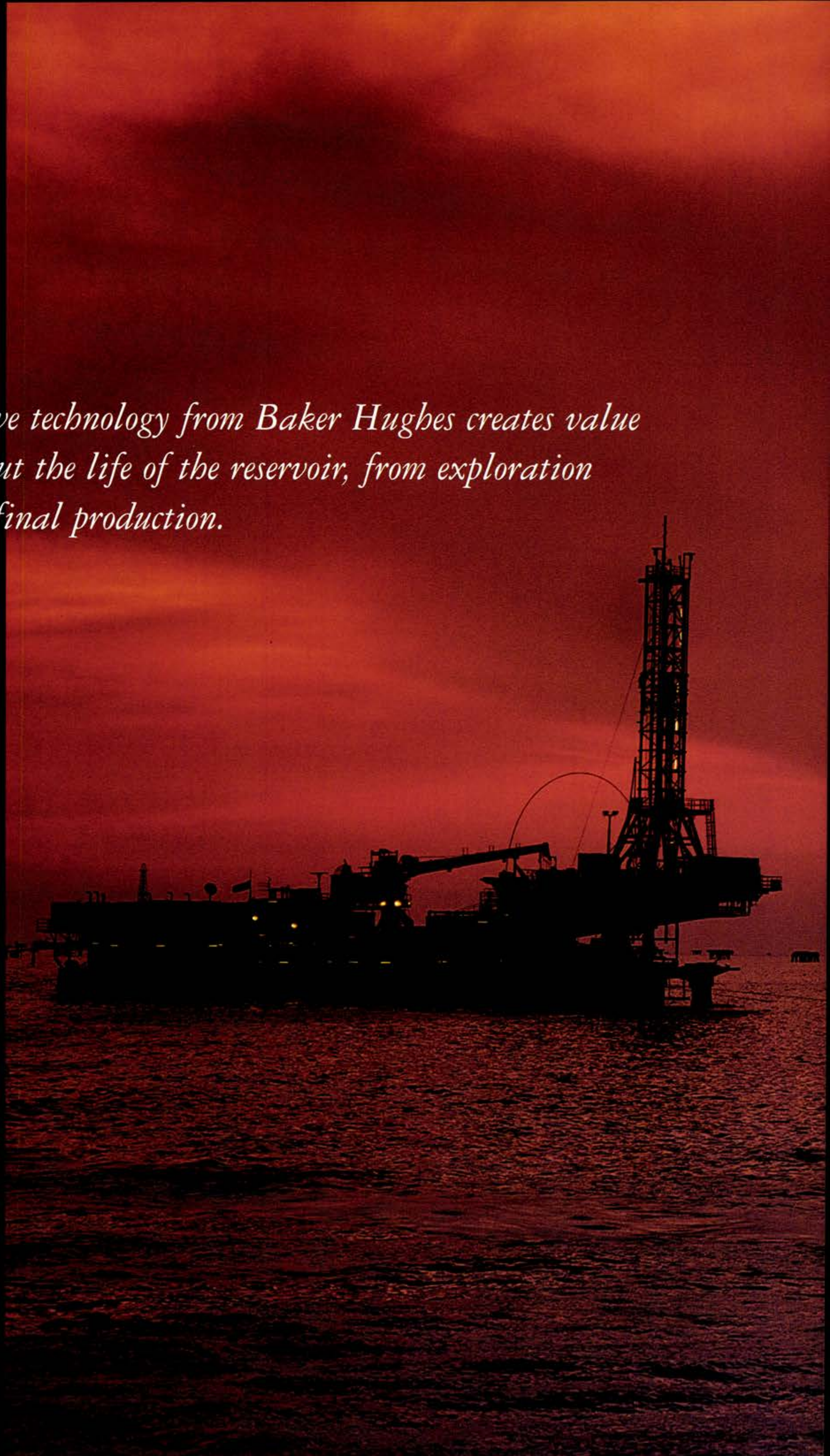
CAPITAL EXPENDITURES

In Millions

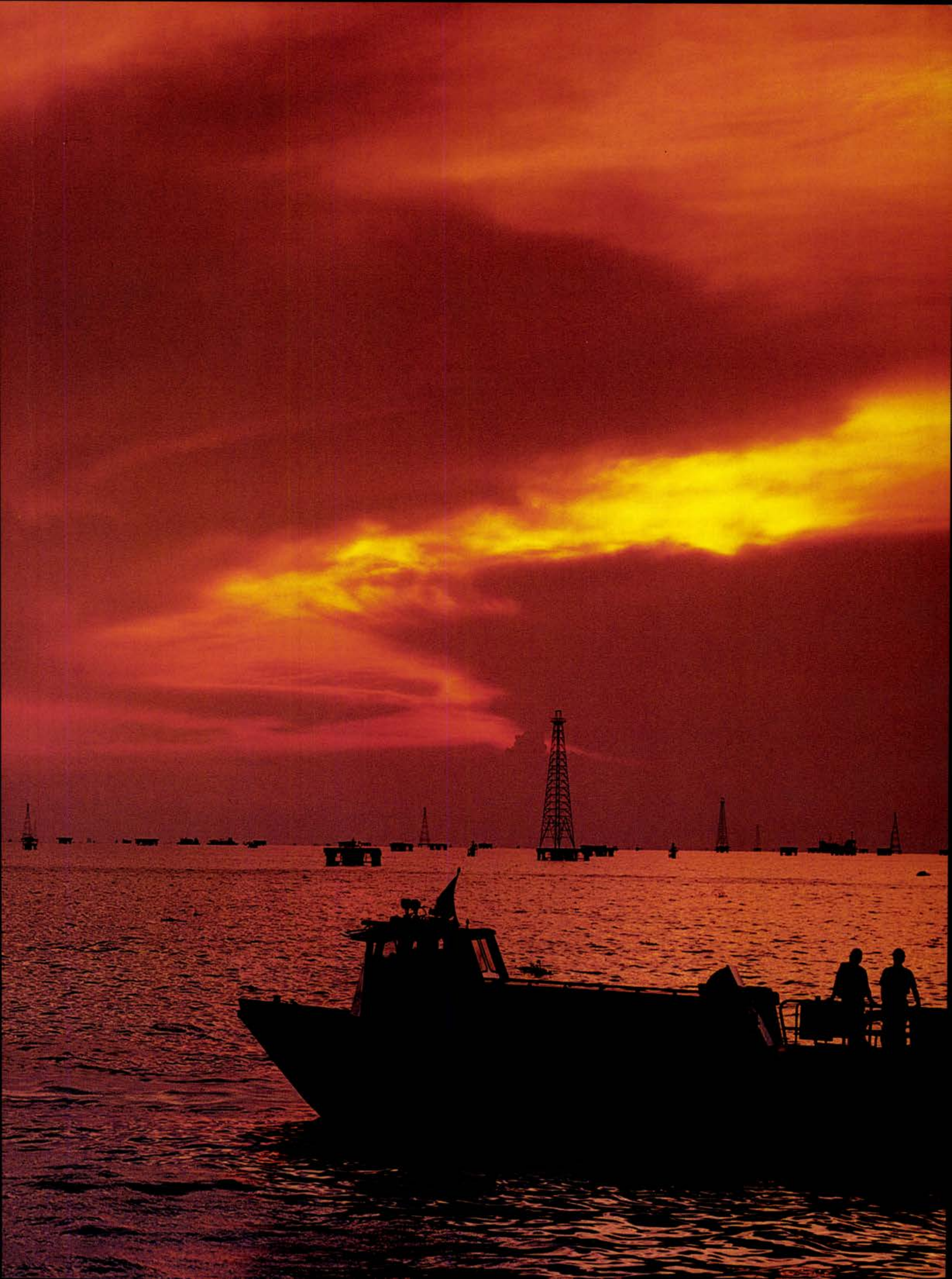
Baker Hughes capital spending has steadily increased for the past three years.



Innovative technology from Baker Hughes creates value throughout the life of the reservoir, from exploration through final production.



The Galileo II Reeled System Technology unit drills a re-entry well on Lake Maracaibo in Venezuela.



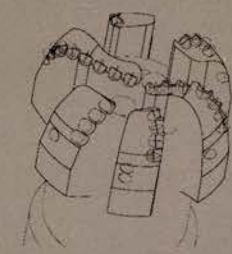
DEVELOPING TECHNOLOGY

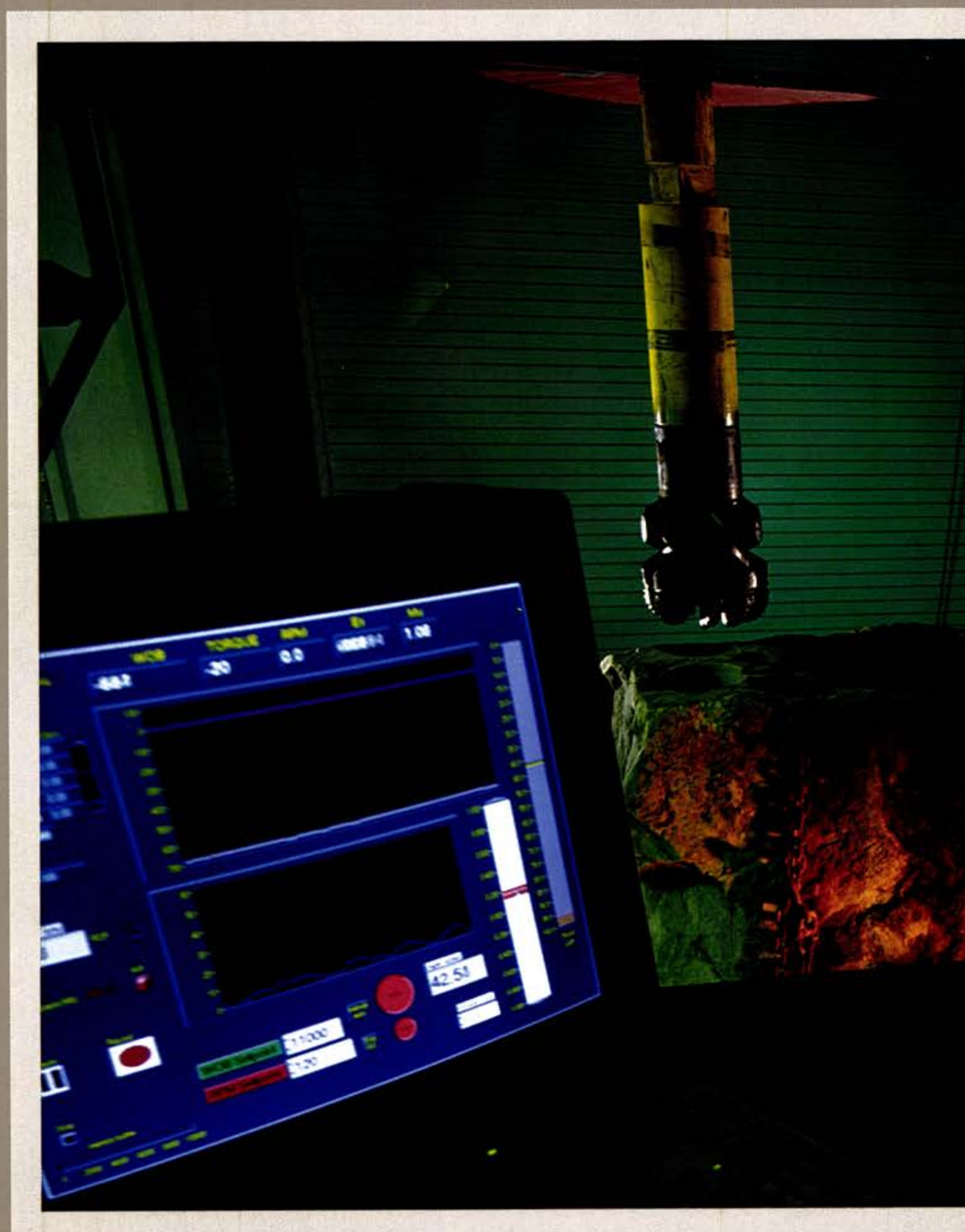
Baker Hughes is a leader in developing and applying advanced technology for oil and gas wells. Our product and service lines span the life of the well from drilling through completion, production and workover.

In recent years, we have built on our mechanical engineering expertise to apply computerized design techniques and sophisticated testing laboratories to quickly develop and refine these technologies.

Hughes Christensen is a good example of this technology transition. The company has used advanced design technology, test labs and state of the art manufacturing to produce a steady flow of new, profitable drill bit designs. Hughes Christensen's revenue grew 13% in 1997, with more than 59% of sales attributable to products that were less than three years old.

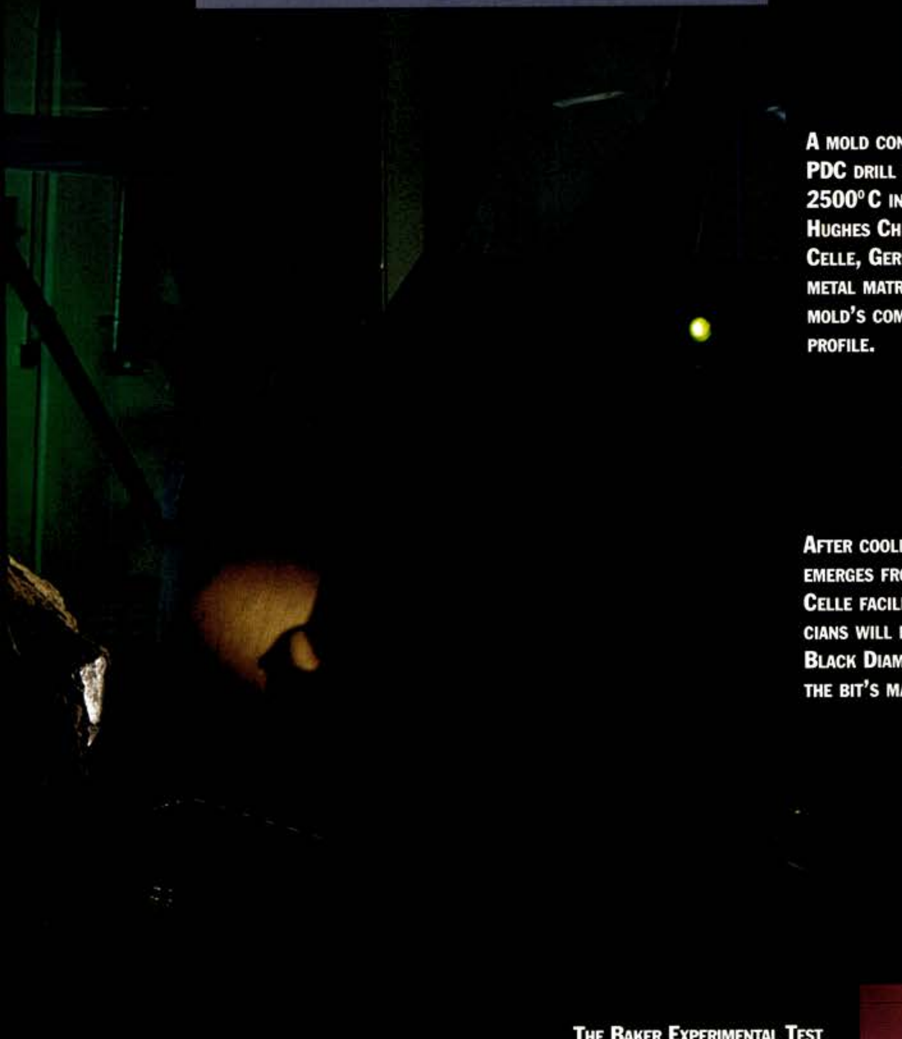
Finite element analysis design techniques enable Hughes Christensen bit engineers to build "virtual" bits and evaluate them before making physical prototypes for testing.





New lines for 1997, the HydraBoss Tricone drill bit and the Black Diamond and Black Trax PDC bits feature technology innovations developed at Hughes Christensen's Woodlands, Texas facility.

HUGHES CHRISTENSEN'S DRILLING SIMULATOR ENABLES ENGINEERS TO TEST NEW DRILL BIT DESIGNS UNDER A VARIETY OF CONDITIONS. THIS ACCELERATES PRODUCT DEVELOPMENT AND CONTRIBUTES TO HUGHES CHRISTENSEN'S TECHNOLOGY LEADERSHIP.



A MOLD CONTAINING A NEW PDC DRILL BIT IS HEATED TO 2500°C IN AN OVEN AT THE HUGHES CHRISTENSEN PLANT IN CELLE, GERMANY. POWDERED-METAL MATRIX CONFORMS TO THE MOLD'S COMPUTER DESIGNED BIT PROFILE.

AFTER COOLING, A PDC BIT EMERGES FROM ITS MOLD AT THE CELLE FACILITY. NEXT, TECHNICIANS WILL BRAZE ADVANCED BLACK DIAMOND CUTTERS TO THE BIT'S MATRIX BODY.

THE BAKER EXPERIMENTAL TEST AREA (BETA) NEAR MOUNDS, OKLAHOMA, IS EQUIPPED WITH A FULL-SIZED DRILLING RIG AND A DATA COLLECTION BUILDING. HERE, BAKER HUGHES ENGINEERS TEST PROTOTYPE PRODUCTS UNDER REAL-LIFE CONDITIONS.

ADVANCED DRILLING SYSTEMS

In 1997, Baker Hughes continued its leadership in directional drilling and measurement-while-drilling. Strong offshore activity, the worldwide growth of horizontal drilling, and broad application of slimhole re-entry technology increased revenues from related product lines by 16%.

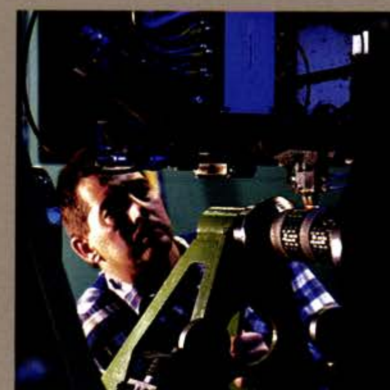
The latest breakthrough in directional drilling is the AutoTrak™ Rotary Closed Loop drilling system. Developed jointly by Baker Hughes INTEQ and AGIP S.p.A., the AutoTrak unit has a downhole guidance system that automatically steers the drilling assembly along a pre-programmed course. Operators on the surface monitor the system via computer and can signal the AutoTrak assembly to re-direct itself to new targets. The system drills an extremely smooth wellpath for extended reach operations. Advanced logging-while-drilling sensors, located near the bit, also give the system superior geosteering capabilities for optimum well placement within the producing reservoir.

The AutoTrak service is expected to command premium pricing. Four major operators have made advance payments to gain early access to this exciting new technology.

Baker Hughes INTEQ maintained a leading technology position in resistivity logging-while-drilling, with its Multiple Propagation Resistivity™ (MPR) tool and NaviGator™ geosteering system. The INTEQ division also continued successful introduction of the Navi-Drill® Ultra Series drilling motors.

Baker Hughes INTEQ 's drilling fluids business gained momentum during 1997, with exceptional growth in the second half. INTEQ is an innovator in reservoir drill-in fluids and synthetic and glycol technology fluid systems, for which the division was awarded a Meritorious Engineering award at the 1997 Offshore Technology Conference by *Petroleum Engineer International.*

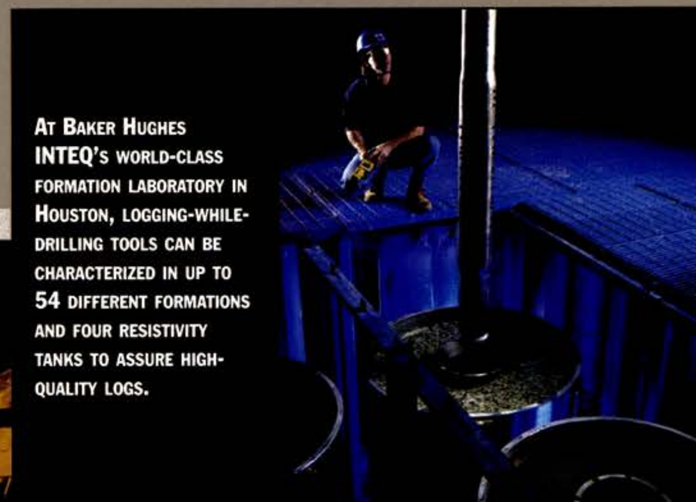
A Baker Hughes INTEQ machinist finishes a Navi-Drill Ultra Series rotor at the division's recently upgraded Houston manufacturing facility.



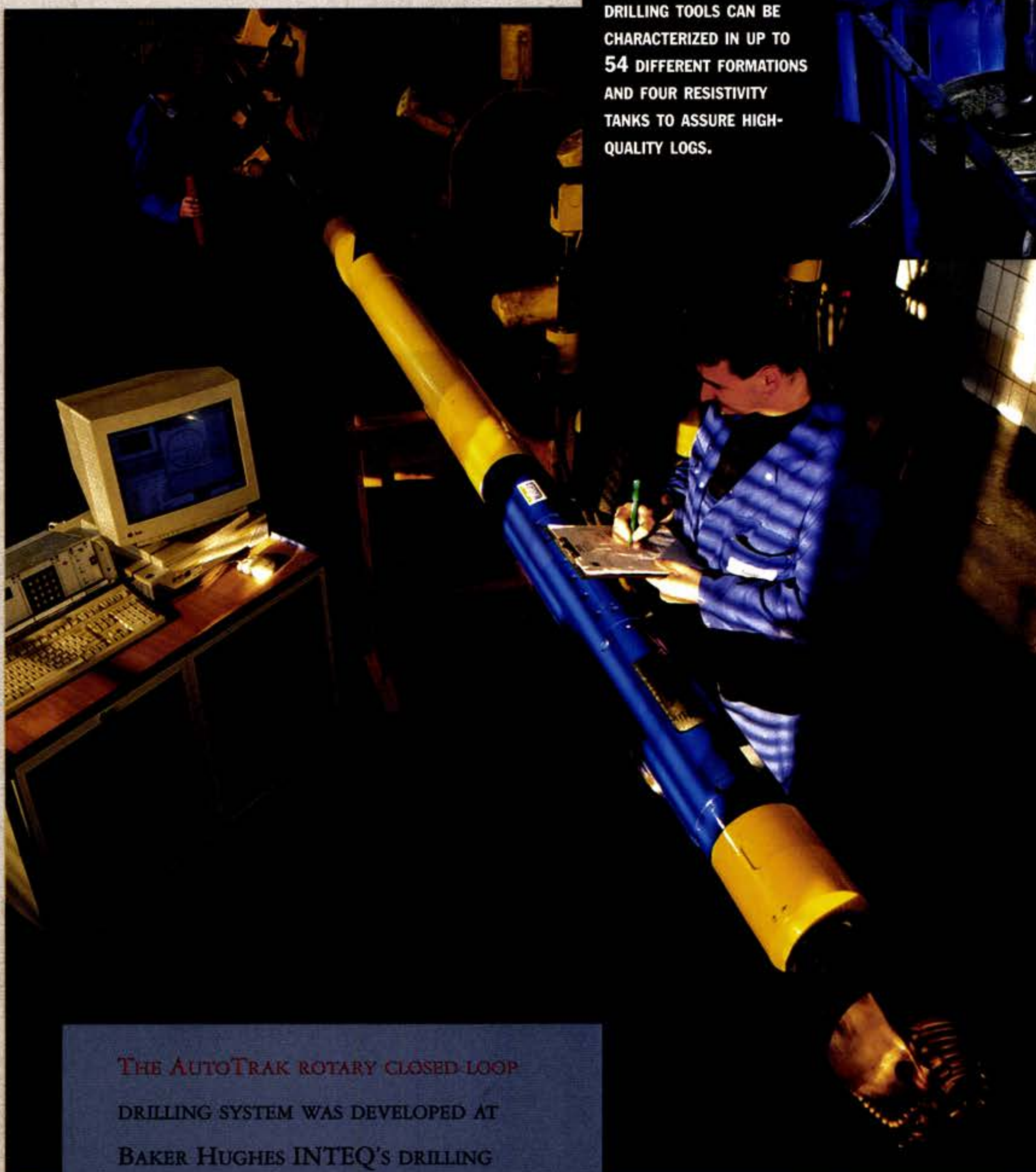
A machine operator in Celle, Germany monitors an automated welding machine as it produces a radial bearing for a drilling motor.

Technicians at INTEQ's Celle, Germany machine shop examine the logging-while-drilling component of an AutoTrak system.

A machinist builds an MPR logging-while-drilling tool on an advanced, computer-controlled milling center.



AT BAKER HUGHES INTEQ'S WORLD-CLASS FORMATION LABORATORY IN HOUSTON, LOGGING-WHILE-DRILLING TOOLS CAN BE CHARACTERIZED IN UP TO 54 DIFFERENT FORMATIONS AND FOUR RESISTIVITY TANKS TO ASSURE HIGH-QUALITY LOGS.



THE AUTOTRAK ROTARY CLOSED LOOP DRILLING SYSTEM WAS DEVELOPED AT BAKER HUGHES INTEQ'S DRILLING RESEARCH CENTER IN CELLE, GERMANY. THE AUTOMATED SYSTEM DRILLS ALONG A PRE-PROGRAMMED WELLPATH WITH HIGHER PENETRATION RATES AND A SMOOTHER HOLE THAN CONVENTIONAL DRILLING SYSTEMS.

THE AUTOTRAK SYSTEM WAS DEVELOPED JOINTLY WITH AGIP S.P.A.

LEADERSHIP IN COMPLETIONS

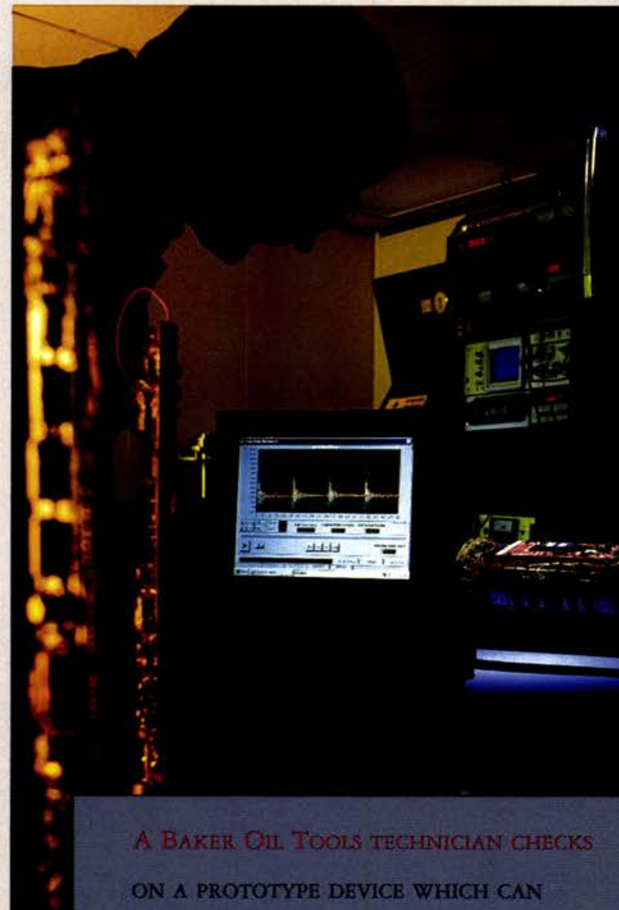
In 1997, Baker Oil Tools grew its completions revenues by 14%, with particular strength in high-technology offshore areas. The division introduced major technical innovations in multilateral systems, intelligent completions and completions for horizontal wells.

Baker Oil Tools established clear technical leadership in multilateral completions with complex level 4 and 5 systems successfully installed in Malaysia, Brunei, Nigeria, the UK and the Gulf of Mexico. These patented systems permit oil companies to separately produce from two or more horizontal legs drilled from a single main vertical well.

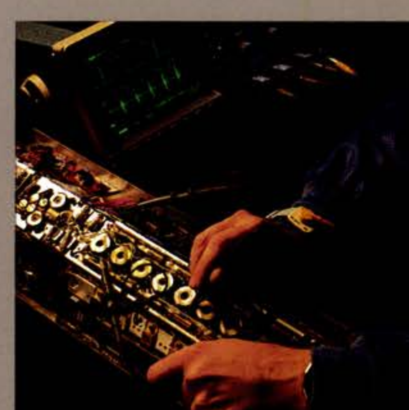
Baker Oil Tools also made significant progress with intelligent completion technology. More than 30 of the division's EDGE systems have been installed to date, mostly in deep water applications. The EDGE system enables packers and flow control equipment to be activated remotely in a fraction of the time required by conventional methods. This saves time on deep water completions.

Baker Oil Tools also advanced the art of horizontal completions during the year. The EXCLUDER well screen – an improved device for keeping sand from being produced with the oil – was installed in more than 450 zones with 145,000 feet of hole including open hole, cased hole and frac-pac applications. The division demonstrated gravel pack technology for horizontal wells, applying proprietary techniques on wells in Trinidad and Norway.

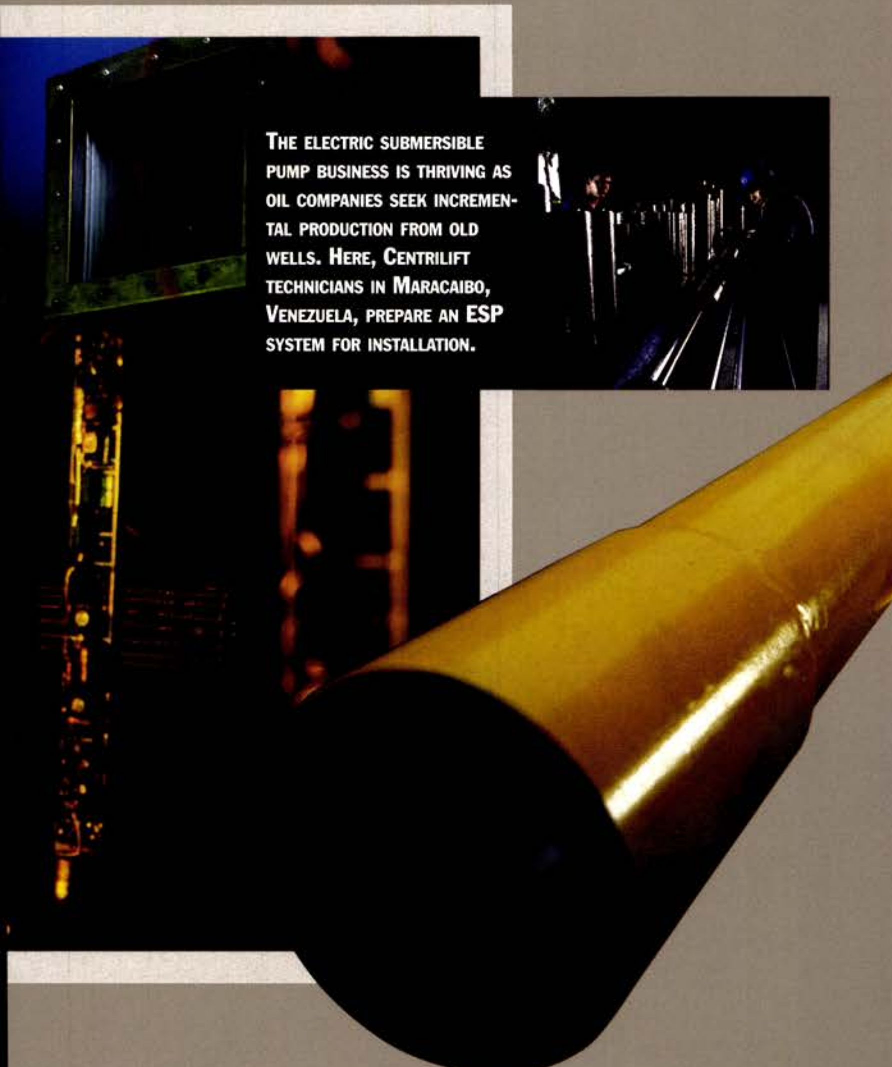
Centrilift continues to be a world leader in electrical submersible pump systems. With gains in the U.S. and Venezuela, Centrilift's business grew more than 28% during the year. The acquisition of Oilfield Dynamics, Inc. (closed in October 1997) has further strengthened Centrilift's position.



A Baker Oil Tools technician checks on a prototype device which can remotely set completion tools using acoustic signals. A similar system received a Meritorious Engineering Award at the 1997 Offshore Technology Conference.



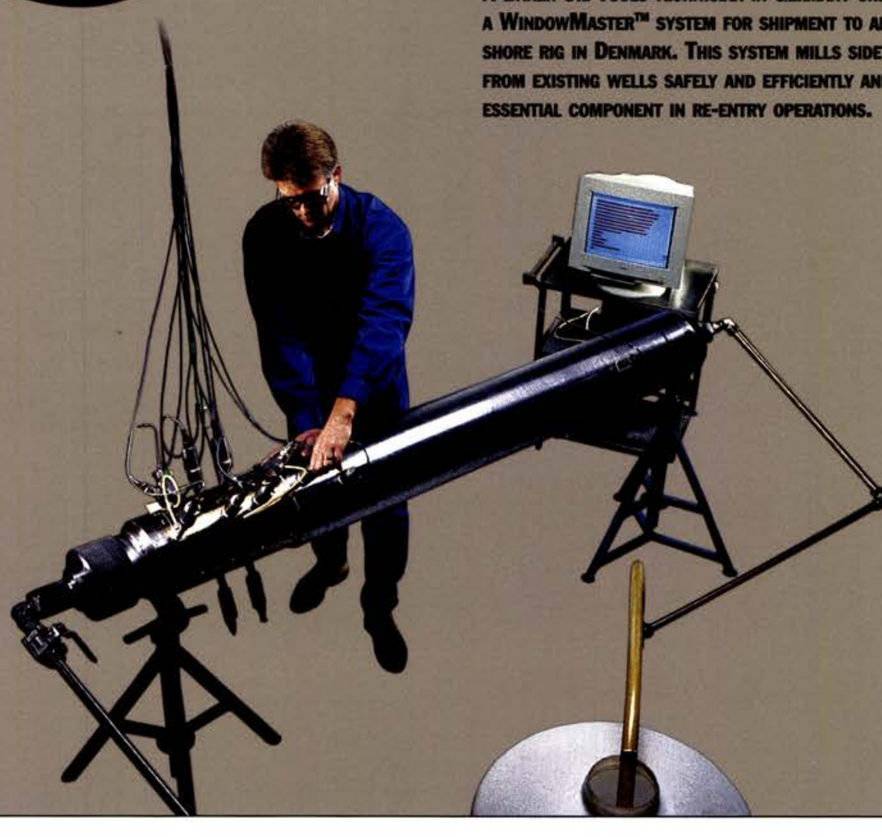
Advanced electronics inside the intelligent completion system can remotely activate a sliding sleeve to control oil flow.



The electric submersible pump business is thriving as oil companies seek incremental production from old wells. Here, Centrilift technicians in Maracaibo, Venezuela, prepare an ESP system for installation.

This new multilateral junction uses expandable metallurgy to provide mechanical integrity and a hydraulic seal where the lateral joins the main wellbore. This innovation will speed multilateral operations while reducing their complexity.

A Baker Oil Tools technician in Germany checks out a WindowMaster™ system for shipment to an offshore rig in Denmark. This system mills sidetracks from existing wells safely and efficiently and is an essential component in re-entry operations.



A Baker Oil Tools engineer tests the new Equalizer system which improves the efficiency of horizontal completions by assuring even production over the entire length of the lateral well.

TEAMWORK AND SYNERGY

Increasingly, engineers from several Baker Hughes divisions are working together to carry out integrated projects and to develop combined systems that provide breakthrough results for clients.

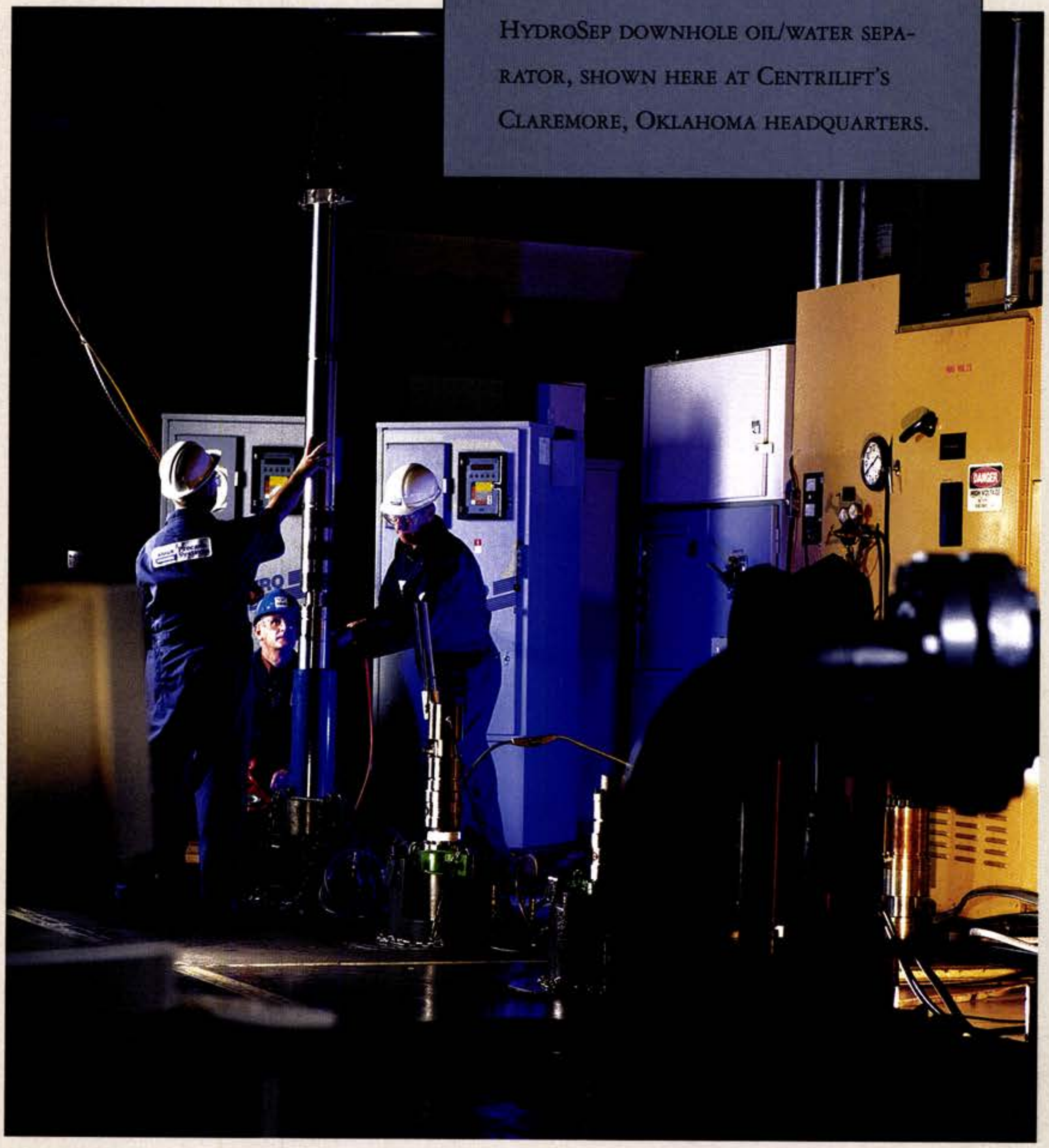
For example, a development team comprised of experts from Centrilift, Baker Hughes Process Systems, and Baker Oil Tools is developing the HydroSep™ downhole oil/water separator. Combining electrical submersible pump technology from Centrilift, the Vortoil hydrocyclone system from BHPS and Baker Oil Tools packer components, the HydroSep system separates oil from water below the surface and reduces surface water treatment requirements by more than 90%. This results in compelling savings for oil companies, especially in offshore fields.

The Galileo Reeled System Technology, commercialized in 1997, combines technology from Baker Hughes INTEQ, Baker Hughes Process Systems, Hughes Christensen and Baker Oil Tools. The Galileo unit has automated controls and competitive innovations that put Baker Hughes at the forefront of coiled tubing drilling technology.

Baker Hughes remains committed to integrating its technologies and to providing project management services. Integrated solutions activity is now spearheaded by the Baker Hughes Solutions division, formed late in 1996. The new division builds on more than 10 years of experience gained since Baker Hughes introduced the concept of integrated solutions to the industry. Baker Hughes Solutions has considerable in-house reservoir engineering expertise for mature field optimization. The division is focusing on developing opportunities in emerging markets, like Venezuela and the Caspian region.

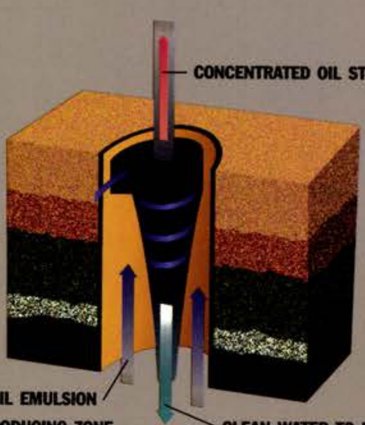
THE GALILEO I REELED TECHNOLOGY UNIT IS ON A LONG-TERM RE-ENTRY CONTRACT IN HOLLAND. THE SYSTEM CAN DRILL WITH COILED TUBING OR JOINTED PIPE. BAKER HUGHES INTEQ'S REELED SYSTEMS WERE THE FIRST COILED TUBING UNITS TO BE SPECIFICALLY DESIGNED FOR EFFICIENT DRILLING OPERATIONS.

THE GALILEO II REELED TECHNOLOGY UNIT IS A SELF-CONTAINED DRILLING/WORKOVER BARGE WHICH USES COILED TUBING/UNDERBALANCED DRILLING TO IMPROVE EFFICIENCY AND WELL PRODUCTIVITY. THE UNIT IS OPERATING ON LAKE MARACAIBO IN VENEZUELA.



ENGINEERS FROM THREE BAKER HUGHES DIVISIONS WORK TOGETHER ON THE TEAM THAT IS INTRODUCING THE HYDROSEP DOWNHOLE OIL/WATER SEPARATOR, SHOWN HERE AT CENTRILIFT'S CLAREMORE, OKLAHOMA HEADQUARTERS.

THE HYDROSEP SYSTEM'S UNIQUE HYDROCYCLONE SEPARATES OIL AND WATER INSIDE THE WELLBORE. MOST OF THE WATER IS RE-INJECTED INTO THE FORMATION AND OIL IS PUMPED TO THE SURFACE. IN ONE INSTALLATION IN WYOMING, THE HYDROSEP RE-INJECTS 5,000 BARELS OF WATER PER DAY AND PRODUCES 400 BARRELS OF OIL, DRAMATICALLY REDUCING WATER TREATMENT AND DISPOSAL COSTS.



STRATEGIC ACQUISITIONS

As part of our strategy for growth and improved performance, we completed three major acquisitions in fiscal year 1997.

Petrolite Corporation, a St. Louis-based manufacturer and marketer of specialty chemicals used in the petroleum and process industries, was acquired on July 2, 1997 for 19.3 million shares of Baker Hughes common stock. Petrolite's operations in the upstream and downstream petroleum markets and in other industries were complementary to those of our Baker Performance Chemicals company. These two companies have been combined to form Baker Petrolite.

With approximately $700 million in annual revenues, Baker Petrolite is a leading supplier of oilfield chemicals. Baker Petrolite offers leading products that solve problems for oil companies as they optimize production from their fields, treat produced water, move crude oil via pipeline, process it at refineries and distribute it to consumers.

Baker Hughes also acquired Drilex International Inc. in a deal that was closed on July 14, 1997. Drilex was a well-established directional drilling and downhole motor supplier which primarily served independent operators in the United States. The company had revenues of $76.1 million in 1996. Drilex was combined with Baker Hughes INTEQ, enhancing its position in North America.

In addition, Baker Hughes also acquired the Environmental Technology Division (ETD) of Deutz AG for $53 million. ETD consists of decanter centrifuge, dryer, and filter press businesses in Germany, South Africa, England and the United States.

ETD has been combined with the Baker Hughes Process Equipment Company (BHPEC) operations as part of its Bird Machine Company division, headquartered in South Walpole, Massachusetts. The acquisition will give Bird a strategic presence in Europe and will provide its customers with increased options and improved service.

ACQUISITION OF PETROLITE MORE THAN DOUBLED OUR CHEMICALS MANUFACTURING CAPACITY.

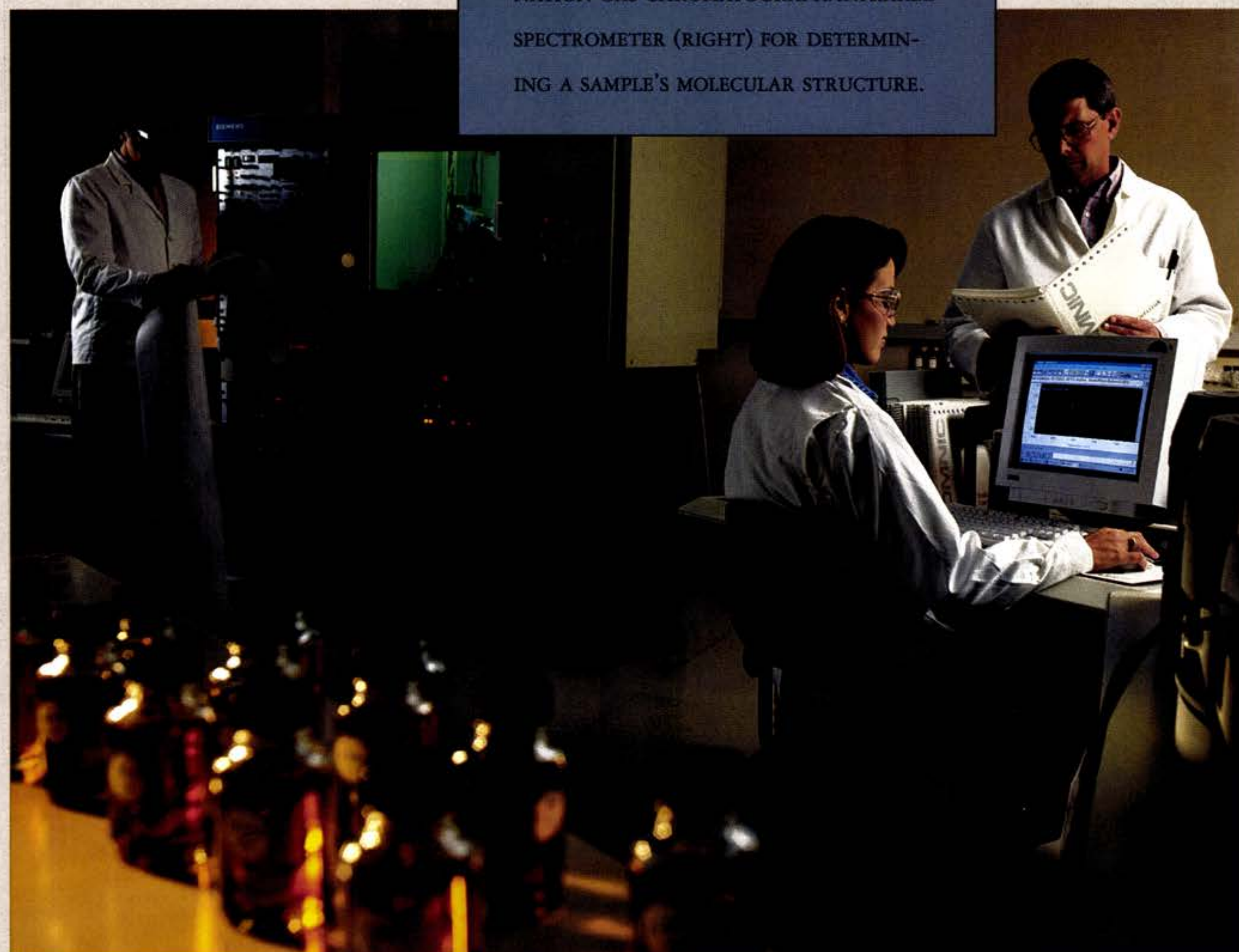
BAKER PETROLITE SERVES THE OILFIELD, PIPELINE, REFINING AND PROCESS INDUSTRIES FROM MORE THAN 50 DISTRIBUTION POINTS WORLDWIDE.

THE ACQUISITION OF DRILEX INTERNATIONAL STRENGTHENED BAKER HUGHES INTEQ'S BUSINESS WITH U.S. INDEPENDENTS AND BROADENED ITS PRODUCT LINE, ESPECIALLY FOR SMALLER-DIAMETER EQUIPMENT USED IN RE-ENTRY HORIZONTAL DRILLING.

BIRD HUMBOLDT

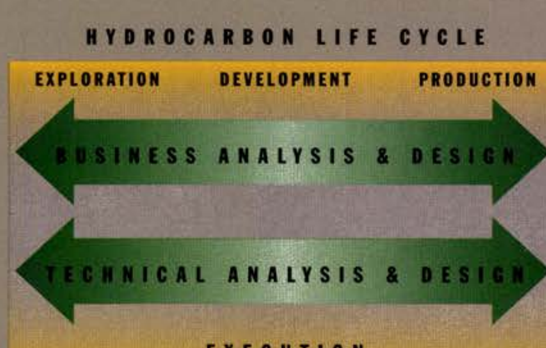
Addition of centrifuge, dryer and filter press product lines purchased from Deutz AG expanded our presence outside the U.S. In Europe these products will be marketed by the new Bird Humboldt subsidiary.

Baker Petrolite scientists use advanced analytical equipment to develop new products and to solve treatment problems for customers. Shown here are X-ray spectrometers (left) used to identify a chemical's elemental composition and a combination gas chromatograph/infrared spectrometer (right) for determining a sample's molecular structure.



As we pursue our vision of providing "life of the field" solutions, potential acquisitions might improve our reservoir analysis and project management capabilities.

HYDROCARBON LIFE CYCLE



LEADERSHIP TEAM

Seated from left to right are Max L. Lukens, G. Stephen Finley, and Eric L. Mattson. Standing from left to right are Andrew J. Szescila, R. Pat Herbert, David H. Barr, and Lawrence O'Donnell, III.

MAX L. LUKENS
CHAIRMAN, PRESIDENT & CHIEF EXECUTIVE OFFICER
BAKER HUGHES INCORPORATED

Mr. Lukens served the first 11 years of his professional career at Deloitte Haskins & Sells. After joining Baker International in 1981, he was VP-Finance for Reed Tubular Products and Milpark Drilling Fluids before being named corporate VP-Chief Financial Officer in 1984. In 1989, he became president of Hughes Tool Company, and subsequently served as group President of Baker Hughes Production Tools and Baker Hughes Oilfield Operations. In 1995, he was named President and Chief Operating Officer for Baker Hughes Incorporated. He became President and Chief Executive Officer in 1996 and was named Chairman and Chief Executive Officer in January 1997. Mr. Lukens earned his BS and MBA at Miami University of Ohio.

ERIC L. MATTSON
SENIOR VICE PRESIDENT AND CHIEF FINANCIAL OFFICER,
BAKER HUGHES INCORPORATED

Mr. Mattson began his professional career at Pittsburgh National Bank. He joined Baker International in 1980 as Assistant Treasurer and was promoted to Treasurer in 1983. In 1987, Mr. Mattson became VP and Treasurer of Baker Hughes Incorporated. He was promoted to his current position in 1993. He earned BS and MBA degrees from the Pennsylvania State University.

G. STEPHEN FINLEY
SENIOR VICE PRESIDENT & CHIEF ADMINISTRATIVE OFFICER,
BAKER HUGHES INCORPORATED

Mr. Finley began his career with Arthur Andersen & Co., and served as audit manager for Price Waterhouse & Co, and International Harvester. In 1982, he joined Baker Oil Tools as a group financial manager and worked as planning manager and international controller for Baker Sand Control. In 1984, he was named VP-Finance for TOTCO and served in the same capacity at Tri-State Oil Tools. In 1987, he became corporate controller at Baker Hughes and was promoted to VP-Controller in 1991. He has held his current position since 1995. He earned a BS degree from Indiana State University.

ANDREW J. SZESCILA
SENIOR VICE PRESIDENT AND PRESIDENT,
BAKER HUGHES OILFIELD OPERATIONS

Mr. Szescila joined Baker Oil Tools in 1973 as a region engineer and served at Baker Sand Control as both VP- North America and VP- Marketing. In

1987, he became president of BJ Services International, then served as president of Baker Service Tools. In 1989, he became president of Hughes Tool Company and oversaw its transformation into Hughes Christensen. He was appointed President of Baker Hughes Oilfield Operations in 1997. Mr. Szescila holds a Petroleum Engineering BS degree from Mississippi State University.

R. Pat Herbert
Vice President, Technology & Market Development, Baker Hughes Incorporated

Mr. Herbert began his oilfield career as an engineer for Smith International where he eventually served as vice president of technology and as operations vice president for both eastern and western hemispheres. In 1988, he was named president of Baker Hughes Drilling Systems and later served as president of Baker Hughes MWD and Develco. In 1993, he was named VP-Technology & Market Development for Baker Hughes Oilfield Operations and assumed the same role for BHI in 1995. Mr. Herbert earned a BS at California State University, Northridge and an MBA at Pepperdine University.

David H. Barr
Vice President Business Process Development, Baker Hughes Incorporated

Mr. Barr joined Hughes Tool Company in 1972 as a region engineer and served in North America and the Far East. He also worked in product management and as general manager of the MPD Carbide Company subsidiary. Also at Hughes Christensen, he served in international and domestic roles as vice president of operations, diamond products, manufacturing and technology. He accepted his current position in 1997 and now leads the Project Renaissance initiative. He holds a BSME degree from Texas Tech University.

Lawrence O'Donnell, III
Vice President and General Counsel, Baker Hughes Incorporated

Mr. O'Donnell received his undergraduate degree in engineering before attending law school. Prior to joining Baker Hughes, he practiced law in Houston and was partner at Campbell & Riggs. In 1991, he joined Baker Hughes as Deputy General Counsel and was named Corporate Secretary the following year. In 1994, he took the assignment as VP-General Counsel, Baker Hughes Oilfield Operations and assumed his current position in 1995. He earned a BS from the University of Texas and a JD cum laude from the University of Houston.

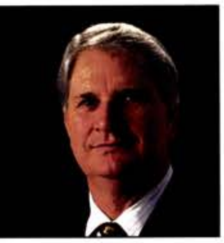
Timothy J. Probert
Vice President and President, Baker Hughes INTEQ

Mr. Probert started his career in 1972 with EXLOG as a field geologist, and progressed as an operations manager in North America, Europe, Africa and the Middle East. He was named president of Milpark Drilling Fluids in 1988, and subsequently served as president of Eastman Christensen, Eastman Teleco, and Baker Hughes Process Equipment Company. He assumed the Presidency of INTEQ in 1996. He earned a BSc from the University of London.

Ed Howell
Vice President and President, Baker Oil Tools

Mr. Howell joined the company as a sales/service engineer in the oilfield chemical business. He progressed through Baker Performance Chemicals' operations and sales management throughout the USA. He was named VP-General Manager of BPCI in 1984 and became president of Baker Service Tools in 1989. When Baker Service Tools was combined with Baker Oil Tools in 1992, Mr. Howell was named president of the new, larger division. He earned BS and MBA degrees from the University of Southern California.

M. Glen Bassett
Vice President and President, Baker Petrolite



Mr. Bassett started his career with Tenneco Incorporated as a plant engineer then joined Petrolite in 1968 as a group research manager. He served in sales, marketing and manufacturing positions and in 1975 was named Manufacturing Division Manager. He joined Baker Performance Chemicals as VP- Research & Manufacturing in 1980 and was named president in 1983. He holds a BS degree from Louisiana Tech University and has attended management programs at the Wharton and Harvard Business Schools.

Joe Brady
Vice President and President, Centrilift

Mr. Brady began his career as a design engineer for General Motors and held product and general management roles at several other companies before joining Baker in 1981 as VP-Engineering of the Kobe, Inc. subsidiary. In 1983, he was named president of Baker Lift Systems and assumed the presidency of Baker CAC in 1987. The following year he was named President of Centrilift. He holds a BS from the General Motors Institute and an MBA from Michigan State University.

Matthew G. Dick
Vice President and President, Baker Hughes Process Equipment Company

Mr. Dick began his career as an engineering apprentice with Rolls Royce. He joined Baker Oil Tools UK Ltd. as manufacturing director and served as managing director of affiliated companies in the UK, India and Brazil. He joined Hughes Tool Company in 1987 and served in various assignments as an operations and manufacturing vice president. In 1993, he was named VP-Eastern Hemisphere for Baker Hughes INTEQ, and in 1996 he was named President of BHPEC.

Jay P. Trahan
Vice President and President, Baker Hughes Solutions

Mr. Trahan began his career as a petroleum engineer for Sun Oil Company. He joined Baker Sand Control in 1978 as a region engineer. In 1985, he was named VP-Marketing for Baker Production Technology, then served as vice president for Baker Service Tools and Baker Sand Control. In 1990, he was named president of Baker Sand Control and in 1993 assumed the role of president of the newly formed Baker Hughes INTEQ. He received his current assignment in 1996. Mr. Trahan earned his BS and MBA from the University of Southwest Louisiana.

D.J. (Doug) Wall
Vice President and President, Hughes Christensen Company

Mr. Wall spent most of his career in management roles with Thomson/ATCO Drilling and Adeco Drilling & Engineering, two of Canada's foremost drilling contractors. In 1992, he was named President of Western Rock Bit, HCC's Canadian distributor where he helped gain leading market shares for Hughes Christensen Tricone and PDC bits in Canada. He joined Hughes Christensen as President in 1997. Mr. Wall earned a BA from the University of Calgary and an MBA from the University of Alberta.

CONDENSED COMPARATIVE CONSOLIDATED FINANCIAL INFORMATION

(In millions, except per share amounts)

	1997	1996	1995	1994	1993
Revenues	$ 3,685.4	$ 3,027.7	$ 2,637.5	$ 2,504.8	$ 2,701.7
Costs and expenses:					
Costs and expenses applicable to revenues	2,256.2	1,837.6	1,608.7	1,551.8	1,706.1
Selling, general and administrative	966.9	814.2	743.0	715.0	757.8
Amortization of goodwill and other intangibles	32.3	29.6	29.9	30.8	36.9
Unusual charge	52.1	39.6		31.8	42.0
Acquired in-process research and development	118.0				
Operating income of business sold				(10.5)	
Total	3,425.5	2,721.0	2,381.6	2,318.9	2,542.8
Operating income	259.9	306.7	255.9	185.9	158.9
Interest expense	(48.6)	(55.5)	(55.6)	(63.8)	(64.7)
Interest income	1.8	3.4	4.8	3.1	5.9
Gain on sale of Varco stock		44.3			
Gain on sale of Pumpsystems				101.0	
Income before income taxes, extraordinary loss and cumulative effect of accounting changes	213.1	298.9	205.1	226.2	100.1
Income taxes	(104.0)	(122.5)	(85.1)	(95.0)	(41.2)
Income before extraordinary loss and cumulative effect of accounting changes	109.1	176.4	120.0	131.2	58.9
Extraordinary loss				(44.3)	
Cumulative effect of accounting changes	(12.1)		(14.6)	(44.2)	
Net income	$ 97.0	$ 176.4	$ 105.4	$ 42.7	$ 58.9
Per share of common stock:					
Income before extraordinary loss and cumulative effect of accounting changes	$ .71	$ 1.23	$ .67	$ .85	$ .34
Net income	.63	1.23	.57	.22	.34
Dividends	.46	.46	.46	.46	.46
Financial Position:					
Cash and cash equivalents	$ 8.6	$ 7.7	$ 6.8	$ 69.2	$ 7.0
Working capital	1,284.2	1,081.1	984.7	855.4	921.0
Total assets	4,756.3	3,297.4	3,166.6	2,999.7	3,143.3
Long-term debt	771.8	673.6	798.4	638.0	935.8
Stockholders' equity	2,604.6	1,689.2	1,513.5	1,638.5	1,610.6

See Note 1 of Notes to Consolidated Financial Statements for a discussion of the adoption of new accounting standards in 1997 and 1995. In 1994, the Company adopted new accounting standards related to accounting for income taxes and employers' accounting for postretirement benefits other than pensions. See Note 4 of Notes to Consolidated Financial Statements for a discussion of acquisitions made in 1997 and 1996. The Company sold EnviroTech Pumpsystems and EnviroTech Measurements and Controls in 1994. See Note 5 of Notes to Consolidated Financial Statements for a description of the unusual charge in 1997 and 1996. The unusual charge in 1994 consisted of the restructuring and reorganization of certain Oilfield divisions and the discontinuance of an MWD product line, offset by an insurance recovery. The unusual charge in 1993 consisted primarily of litigation settlements. The Company repurchased or defeased debt in 1994 resulting in an extraordinary loss.

MANAGEMENT REPORT OF FINANCIAL RESPONSIBILITIES

The management of Baker Hughes Incorporated is responsible for the preparation and integrity of the accompanying consolidated financial statements and all other information contained in this Annual Report. The consolidated financial statements have been prepared in conformity with generally accepted accounting principles and include amounts that are based on management's informed judgments and estimates.

In fulfilling its responsibilities for the integrity of financial information, management maintains and relies on the Company's system of internal control. This system includes written policies, an organizational structure providing division of responsibilities, the selection and training of qualified personnel and a program of financial and operational reviews by a professional staff of corporate auditors. The system is designed to provide reasonable assurance that assets are safeguarded, transactions are executed in accordance with management's authorization and accounting records are reliable as a basis for the preparation of the consolidated financial statements. Management believes that, as of September 30, 1997, the Company's internal control system provides reasonable assurance that material errors or irregularities will be prevented or detected within a timely period and is cost effective.

Management recognizes its responsibility for fostering a strong ethical climate so that the Company's affairs are conducted according to the highest standards of personal and corporate conduct. This responsibility is characterized and reflected in the Company's Standards of Conduct which is distributed throughout the Company. Management maintains a systematic program to assess compliance with the policies included in the code.

The Board of Directors, through its Audit/Ethics Committee composed solely of nonemployee directors, reviews the Company's financial reporting, accounting and ethical practices. The Audit/Ethics Committee recommends to the Board of Directors the selection of independent public accountants and reviews their fee arrangements. It meets periodically with the independent public accountants, management and the corporate auditors to review the work of each and the propriety of the discharge of their responsibilities. The independent public accountants and the corporate auditors have full and free access to the Audit/Ethics Committee, without management present, to discuss auditing and financial reporting matters.

Max L. Lukens

Max L. Lukens
Chairman, President and
Chief Executive Officer

Eric L. Mattson
Senior Vice President and
Chief Financial Officer

James E. Braun

James E. Braun
Vice President and Controller

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with the Company's Consolidated Financial Statements for the years ended September 30, 1997, 1996 and 1995 and the related Notes to Consolidated Financial Statements.

FORWARD-LOOKING STATEMENTS

MD&A includes 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," "expect," "plan," "intend," "estimate," "project," "forecasts," "will," "could," "targeted," "quantified," "may" and similar expressions are intended to identify forward-looking statements. No assurance can be given that actual results may not differ materially from those in the forward-looking statements herein for reasons including the effect of competition, the level of petroleum industry exploration and production expenditures, world economic conditions, prices of, and the demand for, crude oil and natural gas, drilling activity, weather, the legislative environment in the United States and other countries, OPEC policy, conflict in the Middle East and other major petroleum producing or consuming regions, the development of technology that lowers overall finding and development costs and the condition of the capital and equity markets.

BUSINESS ENVIRONMENT

Prior to the fourth quarter of 1997, the Company reported segment information for two business segments - oilfield and process equipment. Beginning in the fourth quarter of 1997, with the acquisition of Petrolite Corporation ("Petrolite"), the Company began reporting segment information for three business segments - oilfield, chemicals and process equipment.

Oilfield

Oilfield Operations consists of five business units - Baker Hughes INTEQ, Baker Hughes Solutions, Baker Oil Tools, Centrilift and Hughes Christensen - that provide products, services and solutions used in the drilling, completion, production and maintenance of oil and gas wells. The business environment for Oilfield Operations and its corresponding operating results are affected significantly by petroleum industry exploration and production expenditures. These expenditures are influenced strongly by oil company expectations about the supply and demand for crude oil and natural gas, energy prices and finding and development costs. Petroleum supply and demand, pricing and finding and development costs, in turn, are influenced by numerous factors including, but not limited to, those described above in "Forward-Looking Statements." Oilfield Operations generated 78% of the Company's consolidated revenues in 1997.

Three key factors to the oilfield service markets are the impact of technology, the growth in outsourcing and partnering, and the need to expand operations to keep pace with the demand for the Company's products and services.

Technology: Advances in the design and application of the Company's products and services allow oil and gas operators to drill and complete wells at a lower overall cost. At the same time, this technology helps accelerate or maintain hydrocarbon production and enhance reserve recovery.

Outsourcing and Partnering: Similarly, oil companies have increased their levels of outsourcing to, and partnering with, service companies because this approach has proven to be effective in lowering finding and development costs. The Company continues to expand and develop its involvement in project management by working closely with customers in project planning, and in the engineering and integration of several products and services into solutions that meet client objectives.

Growth: Expenditures by the Company's customers for exploration and production programs are increasing. In turn, the markets for the Company's products and services are growing as the demand for developing new supplies of hydrocarbons paces the increasing worldwide demand for energy. Such growth requires significant additions to the Company's manufacturing capacity, rental tool fleet and work force.

Worldwide crude oil demand, crude oil and natural gas prices and the Baker Hughes rotary rig count are summarized in the tables below as annual averages followed by the Company's outlook. While reading the Company's outlook set forth below, caution is advised that the factors described above in "Forward-Looking Statements" and "Business Environment" could negatively impact the Company's expectations for oil demand, oil and gas prices and drilling activity.

Worldwide Oil Demand

Fiscal Year (Millions of Bbls/day)	1997	1996	1995
OECD Oil Demand	41.8	41.0	40.2
Non-OECD Oil Demand	31.4	30.4	29.6
Worldwide Oil Demand	73.2	71.4	69.8

OECD - Organization for Economic Cooperation and Development (developed countries)

According to the International Energy Agency, the demand for crude oil is expected to grow annually by 1.4 million to 2.0 million barrels per day through the end of the century. Three-quarters of the incremental demand are expected to be driven by relatively low energy prices, low but increasing energy consumption per capita, and economic growth in non-OECD countries, particularly in Asia and Latin America.

Oil and Gas Prices

Fiscal Year	1997	1996	1995
WTI ($/bbl)	21.83	20.51	18.29
U.S. Spot Natural Gas ($/mcf)	2.47	2.21	1.42

The Company expects crude oil to trade between $18 and $22 per barrel in 1998 while remaining susceptible to short-term price fluctuations and volatility as the growth in worldwide demand is met by increased production. U.S. natural gas prices are expected to moderate somewhat in 1998 as increased imports from Canada, increased production from the U.S. and pipeline de-bottlenecking improve supply availability. Natural gas prices are expected to average above $2/mcf. The Company believes that natural gas prices at or above $2/mcf will sustain the current natural gas exploration and development drilling activity.

Rotary Rig Count

Fiscal Year	1997	1996	1995
U.S. - Land	788	652	638
U.S. - Offshore	118	107	100
Canada	340	247	247
North America	1,246	1,006	985
Latin America	277	279	266
North Sea	58	53	42
Other Europe	57	69	66
Africa	80	76	65
Middle East	150	138	123
Asia Pacific	181	173	186
International	803	788	748
Worldwide	2,049	1,794	1,733
U.S. Workover	1,412	1,306	1,298

The Company anticipates continued growth in the worldwide demand for hydrocarbons that will result in increased spending by oil and gas companies for the development of the hydrocarbon supply. The increase is dependent on continued worldwide economic growth and, in particular, economic growth in developing countries. The increased spending is expected to result in increased drilling activity in most regions.

North America The Company anticipates that the rate of growth in North America drilling activity will slow in 1998. While both offshore and land based activity will remain strong, growth will be limited by a shortage of offshore and land based drilling rigs.

International The Company expects that most international areas will post an increasing rig count in 1998. The Company is forecasting increases in Latin America, the Middle East and the North Sea while activity in Africa and Asia Pacific is forecasted to be flat.

Chemicals

Baker Petrolite is the sole business unit reported in this segment and is the result of combining Baker Performance Chemicals, previously reported in the oilfield segment, and Petrolite, acquired in the fourth quarter of 1997. Baker Petrolite generated 11% of the Company's consolidated revenues in 1997.

Operating in all major oil and gas producing regions of the world, Baker Petrolite manufactures specialty chemicals for inclusion in the sale of integrated chemical technology solutions for petroleum production, transportation and refining. In addition to those business environment factors discussed above for the oilfield segment, the business environment for the chemicals segment is significantly influenced by the trend of continued reduction in the total operating cost of the customer base which includes major multi-national, independent and national or state-owned oil companies. Improvements in chemical technology and its application, as well as the expanded use of alliance relationships, enable Baker Petrolite to reduce overall production, transportation and refining costs.

Baker Petrolite also provides chemical technology solutions to other industrial markets throughout the world including petrochemicals, steel, fuel additives, plastics, imaging and adhesives. The business environments for these markets are individually unique but most are influenced by the general level of gross domestic product.

Process Equipment

Process Equipment consists of three business units - EIMCO Process Equipment, Bird Machine Company and Baker Hughes Process Systems - that provide technologies that separate solids from liquids and liquids from liquids through filtration, sedimentation, centrifugation and flotation processes. The business environment for Process Equipment and its corresponding operating results are affected significantly by spending on large capital projects in the pulp and paper, industrial, refining, chemical and municipal wastewater treatment markets. Spending on capital projects is influenced by numerous factors including, but not limited to, commodity price cycles, especially copper and pulp, the supply and demand for refined products and chemicals, the expanding Asian populations and economies, as well as environmental pressures and legislation. In 1998, Process Equipment anticipates increased capital project activity in the refining, chemical and industrial markets with continued stable copper prices and a rebound in the pulp and paper market as the price for pulp is expected to increase. In addition, the Company anticipates growth from acquisitions and new technology. Process Equipment generated 11% of the Company's consolidated revenues in 1997.

ACQUISITIONS

During 1997, the Company made several strategic acquisitions to expand its technology base and increase its presence in key geographic areas.

Petrolite

On July 2, 1997, the Company completed the acquisition of Petrolite and Wm. S. Barnickel & Company ("Barnickel"), the holder of 47.1% of Petrolite's common stock, by issuing 19.3 million shares of its common stock having an aggregate value of $730.2 million. Additionally, the Company assumed Petrolite's outstanding vested and unvested employee stock options which had a fair market value of $21.0 million resulting in total consideration of $751.2 million. The Company recorded an unusual charge of $35.5 million related to the combination of Petrolite with Baker Performance Chemicals, the Company's existing oilfield and industrial chemicals operations, forming Baker Petrolite, a leading provider of oilfield chemicals in the major oilfield markets. The Petrolite acquisition also expanded the Company's presence in the refining and industrial chemicals businesses.

Environmental Technology Division of Deutz AG

On July 7, 1997, the Company acquired the Environmental Technology Division, a decanter centrifuge and dryer business, of Deutz AG ("ETD") for $53.0 million, subject to certain post-closing adjustments. ETD was combined with Bird Machine Company and gives the Company a significant presence in the municipal segment of the business as well as a significant presence and service capability in Europe and parts of Asia.

Drilex

On July 14, 1997, the Company acquired Drilex International Inc. ("Drilex"), a provider of products and services used in the directional and horizontal drilling and workover of oil and gas wells, for 2.7 million shares of the Company's common stock. The acquisition of Drilex which has been combined with the operations of Baker Hughes INTEQ, provides the Company with an increased presence in the growing U.S. land directional and horizontal drilling market. In connection with the acquisition of Drilex, the Company recorded an unusual charge of $7.1 million related to transaction and other one-time costs.

Oil Dynamics, Inc.

On October 24, 1997, the Company acquired Oil Dynamics, Inc. ("ODI") from Franklin Electric Co. Inc. ODI is a manufacturer of electric submersible pumps used to lift crude oil in producing regions worldwide and has been added to the operations of Centrilift. The purchase price was $31.5 million, subject to certain post-closing adjustments.

RESULTS OF OPERATIONS

Revenues

1997 vs. 1996

Consolidated revenues for 1997 were $3,685.4 million, an increase of 22% over 1996 revenues of $3,027.7 million. Sales revenues were up $419.9 million, an increase of 21%, and services and rentals revenues were up $237.8 million, an increase of 24%. Approximately 64% of the Company's 1997 consolidated revenues were derived from international activities. The three 1997 acquisitions contributed $192.1 million of the revenue improvement.

Oilfield Operations 1997 revenues were $2,862.6 million, an increase of 19.4% over 1996 revenues of $2,397.9 million. Excluding the Drilex acquisition which accounted for $70.5 million of the revenue improvement, the revenue growth of 16.4% outpaced the 14.4% increase in the worldwide rig count. In particular, revenues in Venezuela increased 37.6%, or $58.6 million, as that country continues to work towards its stated goal of significantly increasing oil production.

Chemical revenues were $417.2 million in 1997, an increase of 68.5% over 1996 revenues of $247.6 million. The Petrolite acquisition was responsible for $91.6 million of the improvement. Revenue growth excluding the acquisition was 31.5% driven by the strong oilfield market and the impact of acquiring the remaining portion of a Venezuelan joint venture in 1997. This investment was accounted for on the equity method in 1996.

Process Equipment revenues for 1997 were $386.1 million, an increase of 9.4% over 1996 revenues of $352.8 million. Excluding revenues from 1997 acquisitions of $32.7 million, revenues were flat compared to the prior year due to weakness in the pulp and paper industry combined with delays in customers' capital spending.

1996 vs. 1995

Consolidated revenues for 1996 increased $390.2 million, or 14.8%, over 1995. Sales revenues were up 13.4% and services and rentals revenues were up 17.8%. International revenues accounted for approximately 65% of 1996 consolidated revenues.

Oilfield Operations revenues increased $325.7 million or 15.7% over 1995 revenues of $2,072.2 million. Activity was particularly strong in several key oilfield regions of the world including the North Sea, Gulf of Mexico and Nigeria where revenues were up $93.4 million, $56.8 million and $30.1 million, respectively. Strong drilling activity drove a $35.5 million increase in Venezuelan revenues.

Chemical revenues rose $23.9 million, or 10.7% over 1995 revenues as its oilfield business benefited from increased production levels in the U.S.

Process Equipment revenues for 1996 increased 10.4% over 1995 revenues of $319.6 million. Excluding revenues from 1996 acquisitions of $21.5 million, revenues increased 3.7%. The growth in the minerals processing and pulp and paper industry slowed from the prior year.

Costs and Expenses Applicable to Revenues

Costs of sales and costs of services and rentals have increased in 1997 and 1996 from the prior years in line with the related revenue increases. Gross margin percentages, excluding the effect of a nonrecurring item in 1997, have increased from 39.0% in 1995 to 39.3% in 1996 and 39.4% in 1997. The nonrecurring item relates to finished goods inventory acquired in the Petrolite acquisition that was increased by $21.9 million to its estimated selling price. The Company sold the inventory in the fourth quarter of 1997 and, as such, the $21.9 million is included in cost of sales in 1997.

Selling, General and Administrative

Selling, general and administrative ("SG&A") expense increased $152.7 million in 1997 from 1996 and $71.2 million in 1996 from 1995. The three 1997 acquisitions were responsible for $54.3 million of the 1997 increase. As a percent of consolidated revenues, SG&A was 26.2%, 26.9% and 28.2% in 1997, 1996 and 1995, respectively.

Excluding the impact of acquisitions, the Company added approximately 2,500 employees during 1997 to keep pace with the increased activity levels. As a result, employee training and development efforts increased in 1997 as compared to the previous two years. These increases were partially offset by $4.1 million of foreign exchange gains in 1997 compared to foreign exchange losses of $11.4 million in 1996 due to the devaluation of the Venezuelan Bolivar.

The three year cumulative rate of inflation in Mexico exceeded 100% for the year ended December 31, 1996; therefore, Mexico is considered to be a highly inflationary economy. Effective December 31, 1996, the functional currency for the Company's investments in Mexico was changed from the Mexican Peso to the U.S. Dollar.

Amortization Expense

Amortization expense in 1997 increased $2.7 million from 1996 due to the Petrolite acquisition. Amortization expense in 1996 remained comparable to 1995 as no significant acquisitions or dispositions were made during those two years.

Unusual Charge

1997: During the fourth quarter of 1997, the Company recorded an unusual charge of $52.1 million. In connection with the acquisitions of Petrolite, accounted for as a purchase, and Drilex, accounted for as a pooling of interests, the Company recorded unusual charges of $35.5 million and $7.1 million, respectively, to combine the acquired operations with those of the Company. The charges include the cost of closing redundant facilities, eliminating or relocating personnel and equipment and rationalizing inventories that require disposal at amounts less than their cost. A $9.5 million charge was also recorded as a result of the decision to discontinue a low margin, oilfield product line in Latin America and to sell the Tracor Europa subsidiary, a computer peripherals operations, which resulted in a write-down of the investment to its net realizable value. Cash provisions of the unusual charge totaled $19.4 million. The Company spent $5.5 million in 1997 and expects to spend substantially all of the remaining $13.9 million in 1998. Such expenditures relate to specific plans and clearly defined actions and will be funded from operations and available credit facilities.

1996: During the third quarter of 1996, the Company recorded an unusual charge of $39.6 million. The charge consisted primarily of the write-off of $8.5 million of Oilfield Operations patents that no longer protected commercially significant technology, a $5.0 million impairment of a Latin America joint venture due to changing market conditions in the region in which it operates and restructuring charges totaling $24.1 million. The restructuring charges include the downsizing of Baker Hughes INTEQ's Singapore and Paris operations, a reorganization of EIMCO Process Equipment's Italian operations and the consolidation of certain Baker Oil Tools manufacturing operations. Noncash provisions of the charge totaled $25.3 million and consist primarily of the write-down of assets to net realizable value. The remaining $14.3 million of the charge represents future cash expenditures related to severance under existing benefit arrangements, the relocation of people and equipment and abandoned leases. The Company spent $4.2 million of the cash during 1996, $6.3 million in 1997 and expects to spend the remaining $3.8 million in 1998.

Acquired In-process Research and Development

In the Petrolite acquisition, the Company allocated $118.0 million of the purchase price to in-process research and development. In accordance with generally accepted accounting principles, the Company recorded the acquired in-process research and development as a charge to expense because its technological feasibility had not been established and it had no alternative future use at the date of acquisition.

Interest Expense

Interest expense in 1997 decreased $6.9 million from 1996 due to lower average debt levels, primarily as a result of the maturity of the 4.125% Swiss Franc Bonds in June 1996. Interest expense in 1996 remained comparable to 1995 as slightly higher average debt balances were offset by a slightly lower weighted average interest rate.

Gain on Sale of Varco Stock

In May 1996, the Company sold 6.3 million shares of Varco International, Inc. ("Varco") common stock, representing its entire investment in Varco. The Company received net proceeds of $95.5 million and recognized a pretax gain of $44.3 million. The Company's investment in Varco was accounted for using the equity method. Equity income included in the Consolidated Statements of Operations for 1996 and 1995 was $1.8 million and $3.2 million, respectively.

Income Taxes

During 1997, the Company reached an agreement with the Internal Revenue Service ("IRS") regarding the audit of its 1992 and 1993 U.S. consolidated income tax returns. The principal issue in the examination related to inter-company pricing on the transfer of goods and services between U.S. and non-U.S. subsidiary companies. As a result of the agreement, the Company recognized a tax benefit through the reversal of deferred income taxes previously provided of $11.4 million ($.08 per share) in the quarter ended June 30, 1997.

The effective income tax rate for 1997 was 48.8% as compared to 41.0% in 1996 and 41.5% in 1995. The increase in the rate for 1997 is due in large part to the nondeductible charge for the acquired in-process research and development related to the Petrolite acquisition offset by the IRS agreement as explained above. The effective rates differ from the federal statutory rate in all years due primarily to taxes on foreign operations and nondeductible goodwill amortization. The Company expects the effective income tax rate in 1998 to be between 38% and 39%.

Net Income Per Share of Common Stock

In June 1995, the Company repurchased all outstanding shares of its convertible preferred stock for $167.0 million. The fair market value of the preferred stock was $149.4 million on its date of issuance. The repurchase price in excess of this amount, $17.6 million, is deducted from net income in arriving at net income per share of common stock. In addition, net income is adjusted for dividends on preferred stock of $8.0 million in 1995.

CAPITAL RESOURCES AND LIQUIDITY

Financing Activities

Net cash inflows from financing activities were $22.8 million in 1997 compared to net cash outflows of $152.2 million and $95.5 million in 1996 and 1995, respectively.

Total debt outstanding at September 30, 1997 was $781.4 million, compared to $675.5 million at September 30, 1996 and $801.3 million at September 30, 1995. The debt to equity ratio was .30 at September 30, 1997, compared to .40 at September 30, 1996 and .53 at September 30, 1995. The improvement in 1997 was due primarily to the increase in stockholders' equity resulting from the issuance of 24.6 million shares of the Company's common stock offset by the increase in debt. The 1996 improvement was driven by a decrease in debt levels.

In July 1997, the Company used $57.4 million of cash to repay debt acquired in the Petrolite and Drilex acquisitions. Cash obtained in the Petrolite acquisition and short-term facilities funded the debt repayment. Borrowings under commercial paper and revolving credit facilities increased $96.4 million during 1997 to fund higher levels of working capital in support of increased market activity. In 1996, the Company used $108.4 million of cash to repay the 4.125% Swiss Franc Bonds that matured. The proceeds from the sale of Varco common stock funded the retirement in 1996.

During 1997 and 1996, the price of the Company's common stock increased significantly resulting in $53.4 million and $43.7 million, respectively, of capital raised through the exercise of employee stock options and other employee stock plans.

Cash dividends in 1997 increased due to the increase in the number of shares of common stock outstanding. In June 1995, the Company repurchased all outstanding shares of its convertible preferred stock for $167.0 million. Existing cash on hand and borrowings from commercial paper and revolving credit facilities funded the repurchase. Cash dividends decreased in 1996 due to the repurchase.

At September 30, 1997, the Company had $639.3 million of credit facilities with commercial banks, of which $300.0 million is committed. These facilities are subject to normal banking terms and conditions and do not materially restrict the Company's activities.

Investing Activities

Net cash outflows from investing activities were $219.3 million in 1997 compared to cash outflows of $40.9 million in 1996 and $94.1 million in 1995.

Property additions increased significantly in 1997 to $342.7 million from $182.2 million in 1996 as the Company added capacity to meet the increased market demand. In 1995, property additions were $138.9 million. The majority of the capital expenditures have been for purchases of rental tools to supplement the rental fleet and machinery and equipment and accounted for 46% and 45% of 1997 capital expenditures, respectively. The Company expects 1998 capital expenditures to be in excess of $450 million. Funds provided from operations and outstanding lines of credit are expected to be adequate to meet future capital expenditure requirements.

During June 1997, the Company began a multi-year initiative designed to reengineer the Company's business processes and develop and implement an enterprise wide software system. The initiative, named "Project Renaissance", will utilize SAP's R/3 as its software platform across the whole of the Company. This project is expected to cost in excess of $200 million over a four year period, and annual recurring cost savings in excess of $100 million have been quantified and targeted.

Proceeds from the disposal of assets generated $58.4 million in 1997, $78.5 million in 1996 and $44.8 million in 1995. The Company obtained $68.7 million of cash from the stock for stock acquisitions of Petrolite and Drilex in 1997.

The Company used existing cash on hand and short term borrowings to purchase ETD in 1997 for a purchase price, net of cash acquired, of $52.2 million and to purchase Vortoil Separation Systems and KTM Process Equipment Inc. in 1996 for a purchase price, net of cash acquired, of $32.7 million.

In July 1997, the Company sold all of the marketable securities obtained in the Barnickel acquisition for $48.5 million. In May 1996, the Company sold its entire investment in Varco receiving net proceeds of $95.5 million.

Operating Activities

Net cash inflows from operating activities were $199.5 million, $194.7 million and $127.2 million in 1997, 1996 and 1995, respectively, and continue to provide the principal source of the Company's liquidity. Higher levels of cash generated from net income as adjusted for noncash charges and credits were used to fund increases in receivables and inventories due to increased activity levels.

ACCOUNTING STANDARDS

Postemployment Benefits

The Company adopted Statement of Financial Accounting Standards ("SFAS") No. 112, *Employers' Accounting for Postemployment Benefits*, effective October 1, 1994. The Company recognized a charge to income of $14.6 million ($.10 per share), net of a $7.9 million tax benefit, in the first quarter of 1995. Expense under SFAS No. 112 for 1995 was not significantly different from the prior method of cash basis accounting.

Impairment of Long-Lived Assets

The Company adopted SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of*, effective October 1, 1996. The statement sets forth guidance as to when to recognize an impairment of long-lived assets, including goodwill, and how to measure such an impairment. The methodology set forth in SFAS No. 121 is not significantly different from the Company's prior policy and, therefore, the adoption of SFAS No. 121 did not have a significant impact on the consolidated financial statements, as it relates to impairment of long-lived assets used in operations. However, SFAS No. 121 also addresses the accounting for long-lived assets to be disposed of and requires these assets to be carried at the lower of cost or fair market value, rather than the lower of cost or net realizable value, the method that was previously used by the Company. The Company recognized a charge to income of $12.1 million ($.08 per share), net of a tax benefit of $6.0 million, as the cumulative effect of a change in accounting in the first quarter of 1997.

Stock Based Compensation

In October 1995, the Financial Accounting Standards Board ("FASB") issued SFAS No. 123, *Accounting for Stock-Based Compensation*, effective October 1, 1996. SFAS No. 123 permits, but does not require, a fair value based method of accounting for employee stock option plans that results in compensation expense being recognized in the results of operations when stock options are granted. The Company continues to use the intrinsic value method of accounting for such plans where no compensation expense is recognized when the exercise price of an employee stock option is equal to the market price of the Company's common stock on the grant date.

Earnings Per Share

In February 1997, the FASB issued SFAS No. 128, *Earnings per Share*, which establishes new standards for computing and presenting earnings per share ("EPS"). SFAS No. 128 will require the presentation of "basic" and "diluted" EPS on the face of the income statement, including all prior periods presented, and is effective for the Company in the quarter ending December 31, 1997. The calculation of basic EPS will result in a per share amount equal to that currently presented for income per share of common stock. The calculation of diluted EPS is expected to be lower than the basic EPS calculation by approximately 3%.

Comprehensive Income

In June 1997, the FASB issued SFAS No. 130, *Reporting Comprehensive Income*, which for the Company, is effective in the year ending September 30, 1999. SFAS No. 130 establishes standards for the reporting and displaying of comprehensive income and its components. The Company will be analyzing SFAS No. 130 during 1998 to determine what, if any, additional disclosures will be required.

QUANTITATIVE AND QUALITATIVE MARKET RISK DISCLOSURES

The Company is exposed to certain market risks which are inherent in the Company's financial instruments which arise from transactions which are entered into in the normal course of business. The Company may enter into derivative financial instrument transactions in order to manage or reduce market risk. The Company does not enter into derivative financial instrument transactions for speculative purposes. A discussion of the Company's primary market risk exposures in financial instruments is presented below.

Long-term Debt

The Company is subject to interest rate risk on its long-term fixed interest rate debt. Commercial paper borrowings and borrowings under revolving credit facilities do not give rise to significant interest rate risk because these borrowings have maturities of less than three months. All things being equal, the fair market value of debt with a fixed interest rate will increase as interest rates fall, and the fair market value will decrease as interest rates rise. This exposure to interest rate risk is managed by borrowing money that has a variable interest rate or using interest rate swaps to change fixed interest rate borrowings to variable interest rate borrowings. Generally, the Company maintains a variable interest rate mix of between 50% and 60% of total borrowings. Interest rates have remained relatively stable over the past year, and the Company anticipates such rates to fluctuate modestly over the next year.

The following table sets forth, as of September 30, 1997, the Company's principal cash flows for its long-term debt obligations, which bear a fixed rate of interest and are denominated in U.S. dollars, and the related weighted average interest rates by expected maturity dates. Additionally, the table sets forth the notional amounts and weighted average interest rates of the Company's interest rate swaps by expected maturity.

	1998	1999	2000	2001	2002	Thereafter	Total	Fair Value
Long-term debt		$ 150.0	$ 93.0			$ 485.2(1)	$ 728.2	$ 688.0
Weighted average interest rates		7.73%	8.59%			4.75%	6.08%	
Fixed to variable swaps	$ 230.5		$ 93.0					
Pay rate	3.55%(2)		7.82%(3)					
Receive rate	3.50%		8.59%					

(1) Includes a zero-coupon instrument with an accreted value of $263.3 million at September 30, 1997.
(2) 30-day commercial paper minus 1.96% settled at maturity in May 1998.
(3) Six-month LIBOR plus 2% settled semi-annually, maturing in January 2000.

Included in the table above in the "Thereafter" column is the Company's Liquid Yield Option Notes ("LYONS") which are convertible into Company common stock at the option of the holder. As such, the fair value of the LYONS is determined, in addition to changes in interest rates, by changes in the market price of the Company's common stock. Holding interest rates constant, a 20% decline in the market price of the Company's common stock would cause the fair value of the LYONS at September 30, 1997 to decrease by a comparable percent amount since the LYONS trade more like an equity instrument than a debt instrument because the market price of the Company's common stock at September 30, 1997 of $43.81 is significantly above the LYONS conversion price of $37.35.

Investments

The Company's investment in common stock and common stock warrants of Tuboscope, Inc. ("Tuboscope") is subject to equity price risk as the common stock of Tuboscope is traded on the New York Stock Exchange. Warrants to buy shares of Tuboscope common stock derive their value, in part, from the market value of Tuboscope common stock. This investment is classified as available for sale and, consequently, is reflected in the consolidated statement of financial position at fair value with unrealized gains and losses reported as a separate component of stockholders' equity. At September 30, 1997, the fair value of the Company's investment in common stock and common stock warrants of Tuboscope was $120.5 million. The Tuboscope common stock was valued at the closing price reported on the New York Stock Exchange, and the warrants were valued using the Black-Scholes option-pricing model. No actions have been taken by the Company to hedge this market risk exposure. A 20% decline in the market price of the Tuboscope common stock would cause the fair value of the investment in common stock and common stock warrants of Tuboscope to decrease $26.1 million.

Foreign Currency

The Company's operations are conducted around the world in a number of different currencies. As such, there is exposure to future earnings due to changes in foreign currency exchange rates when transactions are denominated in currencies other than the Company's functional currency, which is the primary currency in which the Company conducts business. The Company hedges all or part of the future earnings exposure when it believes the risk of loss is greater than the cost of the associated hedge. At September 30, 1997, the Company had not entered into any significant foreign exchange or swap contracts.

Certain short-term borrowings of the Company are denominated in a currency other than its functional currency. At September 30, 1997, the Company's non-functional currency short-term borrowings totaled $32.5 million where the primary exposure was to the Pound Sterling and the Dutch Guilder. A 10% appreciation of the U.S. Dollar against each of these currencies would not have a significant effect on the future earnings of the Company.

INDEPENDENT AUDITORS' REPORT

STOCKHOLDERS OF BAKER HUGHES INCORPORATED:

We have audited the consolidated statements of financial position of Baker Hughes Incorporated and its subsidiaries as of September 30, 1997 and 1996, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended September 30, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Baker Hughes Incorporated and its subsidiaries at September 30, 1997 and 1996, and the results of its operations and its cash flows for each of the three years in the period ended September 30, 1997 in conformity with generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, the Company changed its method of accounting for postemployment benefits effective October 1, 1994 to conform with Statement of Financial Accounting Standards No. 112. Also as discussed in Note 1, the Company changed its method of accounting for impairment of long-lived assets to be disposed of effective October 1, 1996 to conform with Statement of Financial Accounting Standards No. 121.

Deloitte & Touche LLP

November 12, 1997
Houston, Texas

CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions, except per share amounts)

Years Ended September 30,	1997	1996	1995
Revenues:			
Sales	$ 2,466.7	$ 2,046.8	$ 1,805.1
Services and rentals	1,218.7	980.9	832.4
Total	3,685.4	3,027.7	2,637.5
Costs and expenses:			
Costs of sales	1,573.3	1,278.1	1,133.6
Costs of services and rentals	682.9	559.5	475.1
Selling, general and administrative	966.9	814.2	743.0
Amortization of goodwill and other intangibles	32.3	29.6	29.9
Unusual charge	52.1	39.6	
Acquired in-process research and development	118.0		
Total	3,425.5	2,721.0	2,381.6
Operating income	259.9	306.7	255.9
Interest expense	(48.6)	(55.5)	(55.6)
Interest income	1.8	3.4	4.8
Gain on sale of Varco stock		44.3	
Income before income taxes and cumulative effect of accounting changes	213.1	298.9	205.1
Income taxes	(104.0)	(122.5)	(85.1)
Income before cumulative effect of accounting changes	109.1	176.4	120.0
Cumulative effect of accounting changes:			
Impairment of long-lived assets to be disposed of (net of $6.0 income tax benefit)	(12.1)		
Postemployment benefits (net of $7.9 income tax benefit)			(14.6)
Net income	$ 97.0	$ 176.4	$ 105.4
Per share of common stock:			
Income before cumulative effect of accounting changes	$ .71	$ 1.23	$ .67
Cumulative effect of accounting changes	(.08)		(.10)
Net income	$ .63	$ 1.23	$ .57

See Notes to Consolidated Financial Statements

BAKER HUGHES INCORPORATED

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(In millions)

September 30,	1997	1996
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 8.6	$ 7.7
Receivables-less allowance for doubtful accounts 1997, $23.9; 1996, $22.9	1,047.1	793.8
Inventories	1,030.5	802.2
Deferred income taxes	83.8	78.7
Other current assets	50.5	34.0
Total current assets	2,220.5	1,716.4
Property-net	982.9	599.0
Other assets	497.5	224.7
Excess costs arising from acquisitions - less accumulated amortization: 1997, $163.1; 1996, $156.9	1,055.4	757.3
Total assets	$ 4,756.3	$ 3,297.4
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 499.7	$ 330.1
Short-term borrowings and current portion of long-term debt	9.6	1.9
Accrued employee compensation and benefits	223.2	155.3
Income taxes payable	48.6	32.9
Other accrued liabilities	155.2	115.1
Total current liabilities	936.3	635.3
Long-term debt	771.8	673.6
Deferred income taxes	275.9	150.5
Other long-term liabilities	167.7	148.8
Commitments and contingencies		
Stockholders' Equity:		
Common stock, one dollar par value (authorized 400.0 shares; outstanding 169.1 shares in 1997 and 144.5 shares in 1996)	169.1	144.5
Capital in excess of par value	2,236.0	1,393.6
Retained earnings	283.7	250.6
Cumulative foreign currency translation adjustment	(144.9)	(118.8)
Unrealized gain on securities available for sale	60.7	19.3
Total stockholders' equity	2,604.6	1,689.2
Total liabilities and stockholders' equity	$ 4,756.3	$ 3,297.4

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In millions, except per share amounts)

For the three years ended September 30, 1997	Preferred Stock	Common Stock	Capital In Excess of Par Value	Retained Earnings	Cumulative Foreign Currency Translation Adjustment	Unrealized Gain (Loss) on Securities Available for Sale	Total
BALANCE, SEPTEMBER 30, 1994	$ 4.0	$ 140.9	$ 1,474.0	$ 125.3	$ (102.9)	$ (2.8)	$ 1,638.5
Net income				105.4			105.4
Cash and accrued dividends on $3.00 convertible preferred stock				(8.0)			(8.0)
Cash dividends on common stock ($.46 per share)				(65.0)			(65.0)
Foreign currency translation adjustment					(4.8)		(4.8)
Repurchase of $3.00 convertible preferred stock	(4.0)		(145.4)	(17.6)			(167.0)
Unrealized loss adjustment						(0.6)	(0.6)
Stock issued pursuant to employee stock plans		1.3	13.7				15.0
BALANCE, SEPTEMBER 30, 1995		142.2	1,342.3	140.1	(107.7)	(3.4)	1,513.5
Net income				176.4			176.4
Cash dividends on common stock ($.46 per share)				(65.9)			(65.9)
Foreign currency translation adjustment					(11.1)		(11.1)
Unrealized gain adjustment, net of $12.2 tax charge						22.7	22.7
Stock issued pursuant to employee stock plans		2.3	46.2				48.5
Tax benefit related to employee stock plans			5.1				5.1
BALANCE, SEPTEMBER 30, 1996		144.5	1,393.6	250.6	(118.8)	19.3	1,689.2
Drilex pooling of interests		2.7	46.9	5.7			55.3
Net income				97.0			97.0
Cash dividends on common stock ($.46 per share)				(69.6)			(69.6)
Foreign currency translation adjustment					(26.1)		(26.1)
Unrealized gain adjustment, net of $22.3 tax charge						41.4	41.4
Petrolite acquisition		19.3	731.9				751.2
Stock issued pursuant to employee stock plans		2.6	52.6				55.2
Tax benefit related to employee stock plans			11.0				11.0
BALANCE, SEPTEMBER 30, 1997		$ 169.1	$ 2,236.0	$ 283.7	$ (144.9)	$ 60.7	$ 2,604.6

See Notes to Consolidated Financial Statements

BAKER HUGHES INCORPORATED

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

Years Ended September 30,	1997	1996	1995
Cash Flows From Operating Activities:			
Net income	$ 97.0	$ 176.4	$ 105.4
Adjustments to reconcile net income to net cash flows from operating activities:			
Depreciation and amortization of:			
Property	143.9	115.9	114.2
Other assets and debt discount	42.1	39.9	40.4
Deferred income taxes	(6.8)	30.2	44.8
Noncash portion of unusual charge	32.7	25.3	
Acquired in-process research and development	118.0		
Gain on sale of Varco stock		(44.3)	
Gain on disposal of assets	(18.4)	(31.7)	(18.3)
Foreign currency translation (gain)/loss-net	(6.1)	8.9	1.9
Cumulative effect of accounting changes	12.1		14.6
Change in receivables	(129.8)	(84.1)	(94.7)
Change in inventories	(114.9)	(73.8)	(79.9)
Change in accounts payable	65.3	22.6	51.7
Changes in other assets and liabilities	(35.6)	9.4	(52.9)
Net cash flows from operating activities	199.5	194.7	127.2
Cash Flows From Investing Activities:			
Property additions	(342.7)	(182.2)	(138.9)
Proceeds from disposal of assets	58.4	78.5	44.8
Cash obtained in stock acquisitions	68.7		
Acquisition of businesses, net of cash acquired	(52.2)	(32.7)	
Proceeds from sale of investments	48.5	95.5	
Net cash flows from investing activities	(219.3)	(40.9)	(94.1)
Cash Flows From Financing Activities:			
Net borrowings (payments) from commercial paper and revolving credit facilities	96.4	(21.6)	42.7
Repayment of indebtedness	(57.4)	(108.4)	
Proceeds from exercise of stock options	53.4	43.7	9.8
Dividends	(69.6)	(65.9)	(74.0)
Proceeds from exercise of debenture purchase warrants			93.0
Repurchase of preferred stock			(167.0)
Net cash flows from financing activities	22.8	(152.2)	(95.5)
Effect of exchange rate changes on cash	(2.1)	(0.7)	-
Increase (decrease) in cash and cash equivalents	0.9	0.9	(62.4)
Cash and cash equivalents, beginning of year	7.7	6.8	69.2
Cash and cash equivalents, end of year	$ 8.6	$ 7.7	$ 6.8

See Notes to Consolidated Financial Statements

NOTE 1
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation: The consolidated financial statements include the accounts of Baker Hughes Incorporated and all majority owned subsidiaries (the "Company"). Investments in which the Company owns 20% to 50% and exercises significant influence over operating and financial policies are accounted for on the equity method. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain 1996 and 1995 amounts have been reclassified to conform to the 1997 presentation. In the Notes to Consolidated Financial Statements, all dollar amounts in tabulations are in millions of dollars unless otherwise indicated.

Use of estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue recognition: Revenue from product sales are recognized upon delivery of products to the customer. Revenue from services and rentals are recorded when such services are rendered.

Inventories: Inventories are stated primarily at the lower of average cost or market.

Property: Property is stated principally at cost less accumulated depreciation, which is generally provided using the straight-line method over the estimated useful lives of individual items. The Company manufactures a substantial portion of its rental tools and equipment, and the cost of these items includes direct and indirect manufacturing costs. The Company is implementing an enterprise-wide software system. External direct costs of consulting services and payroll related cost of employees who work full time on implementation of the enterprise-wide software system are capitalized. Costs associated with business process reengineering and training are expensed as incurred.

Impairment of assets: The Company adopted Statement of Financial Accounting Standards ("SFAS") No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of*, effective October 1, 1996. The statement sets forth guidance as to when to recognize an impairment of long-lived assets, including goodwill, and how to measure such an impairment. The methodology set forth in SFAS No. 121 is not significantly different from the Company's prior policy and, therefore, the adoption of SFAS No. 121 did not have a significant impact on the consolidated financial statements as it relates to impairment of long-lived assets used in operations. However, SFAS No. 121 also addresses the accounting for long-lived assets to be disposed of and requires these assets to be carried at the lower of cost or fair market value, rather than the lower of cost or net realizable value, the method that was previously used by the Company. The Company recognized a charge to income of $12.1 million ($.08 per share), net of a tax benefit of $6.0 million, as the cumulative effect of a change in accounting in the first quarter of 1997.

Investments: Investments in debt and equity securities, other than those accounted for by the equity method, are classified as available for sale and reported at fair value with unrealized gains or losses, net of tax, recorded as a separate component of stockholders' equity.

Excess costs arising from acquisitions: Excess costs arising from acquisitions are amortized on the straight-line method over the lesser of its expected useful life or forty years.

Income taxes: Deferred income taxes are determined utilizing an asset and liability approach. This method gives consideration to the future tax consequences associated with differences between the financial accounting and tax basis of assets and liabilities.

Environmental matters: Remediation costs are accrued based on estimates of known environmental remediation exposure. Such accruals are recorded even if significant uncertainties exist over the ultimate cost of the remediation. Ongoing environmental compliance costs, including maintenance and monitoring costs, are expensed as incurred.

Stock based compensation: The intrinsic value method of accounting is used for stock based employee compensation whereby no compensation expense is recognized when the exercise price of an employee stock option is equal to the market price of the Company's common stock on the grant date. Additionally, no expense is recognized for shares issued under the Company's employee stock purchase plan.

Postemployment benefits: The Company adopted SFAS No. 112, *Employers' Accounting for Postemployment Benefits*, effective October 1, 1994. The standard requires that the cost of benefits provided to former or inactive employees after employment, but before retirement, be accrued when it is probable that a benefit will be provided, or in the case of service related benefits, over the period earned. The cost of providing these benefits was previously recognized as a charge to income in the period the benefits were paid. The cumulative effect of adopting SFAS No. 112 was a charge to income of $14.6 million ($.10 per share), net of a tax benefit of $7.9 million, in the first quarter of 1995.

Foreign currency translation: Gains and losses resulting from balance sheet translation of foreign operations where a foreign currency is the functional currency are included as a separate component of stockholders' equity. Gains and losses resulting from balance sheet translation of foreign operations where the U.S. Dollar is the functional currency are included in the consolidated statements of operations.

Financial instruments: The Company uses forward exchange contracts and currency swaps to hedge certain firm commitments and transactions denominated in foreign currencies. Gains and losses on forward contracts are deferred and offset against foreign exchange gains or losses on the underlying hedged item. The Company uses interest rate swaps to manage interest rate risk. The interest differentials from interest rate swaps are recognized as an adjustment to interest expense. The Company's policies do not permit financial instrument transactions for speculative purposes.

Income per share: Net income per common share is based on the weighted average number of shares outstanding during the respective periods and excludes the negligible dilutive effect of shares issuable in connection with employee stock and stock option plans.

The following table presents information necessary to calculate net income per common share for the periods indicated:

	1997	1996	1995
Net income	$ 97.0	$176.4	$105.4
Less:			
Preferred stock dividends			(8.0)
Effect of preferred stock repurchase			(17.6)
Net income applicable to common stock	$ 97.0	$176.4	$ 79.8
Weighted average shares outstanding	153.1	143.3	141.2

In June 1995, the Company repurchased all outstanding shares of its convertible preferred stock for $167.0 million. The fair market value of the preferred stock was $149.4 million on its original date of issuance. The repurchase price in excess of this amount, $17.6 million, is deducted from net income in arriving at net income per share of common stock.

Statements of cash flows: The Company considers all highly liquid investments with an original maturity of three months or less at the time of purchase to be cash equivalents.

NOTE 2
INVENTORIES

Inventories are comprised of the following:

	1997	1996
Finished goods	$ 832.3	$ 665.7
Work in process	98.3	70.6
Raw materials	99.9	65.9
Total	$1,030.5	$ 802.2

NOTE 3
PROPERTY, PLANT & EQUIPMENT

Property, plant and equipment is comprised of the following:

	1997	1996
Land	$ 42.6	$ 27.3
Buildings	372.7	290.7
Machinery and equipment	814.0	577.2
Rental tools and equipment	782.7	621.1
Total property	2,012.0	1,516.3
Accumulated depreciation	(1,029.1)	(917.3)
Property - net	$ 982.9	$ 599.0

NOTE 4
ACQUISITIONS AND DISPOSITIONS

1997

Petrolite

In July 1997, the Company acquired Petrolite Corporation ("Petrolite") and Wm. S. Barnickel & Company ("Barnickel"), the holder of 47.1% of Petrolite's common stock, for 19.3 million shares of the Company's common stock having a value of $730.2 million in a three-way business combination accounted for using the purchase method of accounting. Additionally, the Company assumed Petrolite's outstanding vested and unvested employee stock options which were converted into the right to acquire 1.0 million shares of the Company's common stock. Such assumption of Petrolite options by the Company had a fair market value of $21.0 million resulting in total consideration in the acquisitions of $751.2 million. Petrolite, previously a publicly held company, is a manufacturer and marketer of specialty chemicals used in the petroleum and process industries. Barnickel was a privately held company that owned marketable securities, that were sold after the acquisition, in addition to its investment in Petrolite.

The purchase price has been allocated to the assets purchased and the liabilities assumed based on their estimated fair market values at the date of acquisition as follows:

Working capital	$ 64.5
Property	170.1
Prepaid pension cost	80.3
Intangible assets	126.0
Other assets	89.6
In-process research and development	118.0
Goodwill	263.7
Debt	(31.7)
Deferred income taxes	(106.7)
Other liabilities	(22.6)
Total	$ 751.2

In accordance with generally accepted accounting principles, the amount allocated to in-process research and development, which was determined by an independent valuation, has been recorded as a charge to expense in the fourth quarter of 1997 because its technological feasibility had not been established and it had no alternative future use at the date of acquisition.

The Company incurred certain liabilities as part of the plan to combine the operations of Petrolite with those of the Company. These liabilities relate to the Petrolite operations and include severance of $13.8 million for redundant marketing, manufacturing and administrative personnel, relocation of $5.8 million for moving equipment and transferring marketing and technology personnel, primarily from St. Louis to Houston, and environmental remediation of $16.5 million for redundant properties and facilities that will be sold. Cash spent during the fourth quarter of 1997 totaled $7.7 million. The Company anticipates completing these activities in 1998, except for some environmental remediation which will occur in 1998 and 1999.

The operating results of Petrolite and Barnickel are included in the 1997 consolidated statement of operations from the acquisition date, July 2, 1997. The following unaudited pro forma information combines the results of operations of the Company, Petrolite and Barnickel assuming the acquisitions had occurred at the beginning of the periods presented. The pro forma summary does not necessarily reflect the results that would have occurred had the acquisitions been completed for the periods presented, nor do they purport to be indicative of the results that will be obtained in the future, and excludes certain nonrecurring charges related to the acquisition which have an after tax impact of $155.2 million.

(Per share amounts in dollars)	1997	1996
Revenues	$ 3,944.0	$ 3,388.4
Income before accounting change	283.9	189.3
Income per share before accounting change	1.69	1.16

In connection with the acquisition of Petrolite, the Company recorded an unusual charge of $35.5 million. See Note 5 of Notes to Consolidated Financial Statements.

Environmental Technology Division of Deutz AG

In July 1997, the Company acquired the Environmental Technology Division, a decanter centrifuge and dryer business, of Deutz AG ("ETD") for $53.0 million, subject to certain post-closing adjustments. This acquisition is now part of Bird Machine Company and has been accounted for using the purchase method of accounting. Accordingly, the cost of the acquisition has been allocated to assets acquired and liabilities assumed based on their estimated fair market values at the date of acquisition, July 7, 1997. The operating results of ETD are included in the 1997 consolidated statement of operations from the acquisition date. Pro forma results of the acquisition have not been presented as the pro forma revenue, income before accounting change and earnings per share would not be materially different from the Company's actual results. For its most recent fiscal year ended December 31, 1996, ETD had revenues of $103.0 million.

Drilex

In July 1997, the Company acquired Drilex International Inc. ("Drilex") a provider of products and services used in the directional and horizontal drilling and workover of oil and gas wells for 2.7 million shares of the Company's common stock. The acquisition was accounted for using the pooling of interests method of accounting. Under this method of accounting, the historical cost basis of the assets and liabilities of the Company and Drilex are combined at recorded amounts and the results of operations of the combined companies for 1997 are included in the 1997 consolidated statement of operations. The historical results of the separate companies for years prior to 1997 are not combined because the retained earnings and results of operations of Drilex are not material to the consolidated financial statements of the Company. In connection with the acquisition of Drilex, the Company recorded an unusual charge of $7.1 million for transaction and other one time costs associated with the acquisition. See Note 5 of Notes to Consolidated Financial Statements. For its fiscal year ended December 31, 1996 and 1995, Drilex had revenues of $76.1 million and $57.5 million, respectively.

1996

In April 1996, the Company purchased the assets and stock of a business operating as Vortoil Separation Systems, and certain related oil/water separation technology, for $18.8 million. In June 1996, the Company purchased the stock of KTM Process Equipment, Inc., a centrifuge company, for $14.1 million. These acquisitions are part of Baker Hughes Process Equipment Company and have been accounted for using the purchase method of accounting. Accordingly, the costs of the acquisitions have been allocated to assets acquired and liabilities assumed based on their estimated fair market values at the dates of acquisition. The operating results are included in the consolidated statements of operations from the respective acquisition dates.

In April 1996, the Company exchanged the 100,000 shares of Tuboscope Inc. ("Tuboscope") Series A convertible preferred stock held by the Company since October 1991, for 1.5 million shares of Tuboscope common stock and a warrant to purchase 1.25 million shares of Tuboscope common stock. The warrants are exercisable at $10 per share and expire on December 31, 2000.

In May 1996, the Company sold 6.3 million shares of Varco International, Inc. ("Varco") common stock, representing its entire investment in Varco. The Company received net proceeds of $95.5 million and recognized a pretax gain of $44.3 million. The Company's investment in Varco was accounted for using the equity method. Equity income included in the consolidated statements of operations for 1996 and 1995 was $1.8 million and $3.2 million, respectively.

NOTE 5
UNUSUAL CHARGE

1997

During the fourth quarter of 1997, the Company recognized a $52.1 million unusual charge consisting of the following:

Baker Petrolite:	
Severance for 140 employees	$ 2.2
Relocation of people and equipment	3.4
Environmental	5.0
Abandoned leases	1.5
Integration costs	2.8
Inventory write-down	11.3
Write-down of other assets	9.3
Drilex:	
Write-down of property and other assets	4.1
Banking and legal fees	3.0
Discontinued product lines:	
Severance for 50 employees	1.5
Write-down of inventory, property and other assets	8.0
Total	$ 52.1

In connection with the acquisitions of Petrolite and Drilex, the Company recorded unusual charges of $35.5 million and $7.1 million, respectively, to combine the acquired operations with those of the Company. The charges include the cost of closing redundant facilities, eliminating or relocating personnel and equipment and rationalizing inventories that require disposal at amounts less than their cost. A $9.5 million charge was recorded as a result of the decision to discontinue a low margin, oilfield product line in Latin America and to sell the Tracor Europa subsidiary, a computer peripherals operation, which resulted in a write-down of the investment to net realizable value. Cash provisions of the unusual charge totaled $19.4 million. The Company spent $5.5 million in 1997 and expects to spend substantially all of the remaining $13.9 million in 1998.

1996

During the third quarter of 1996, the Company recognized a $39.6 million unusual charge consisting of the following:

Patent write-off	$ 8.5
Impairment of joint venture	5.0
Restructurings:	
Severance for 360 employees	7.1
Relocation of people and equipment	2.3
Abandoned leases	2.8
Inventory write-down	1.5
Write-down of assets	10.4
Other	2.0
Total	$ 39.6

The Company has certain oilfield operations patents which no longer protect commercially significant technology resulting in the write-off of $8.5 million. A $5.0 million impairment of a Latin America joint venture was recorded due to changing market conditions in the region in which it operates. The Company recorded a $24.1 million restructuring charge including the downsizing of Baker Hughes INTEQ's Singapore and Paris operations, a reorganization of EIMCO Process Equipment's Italian operations and the consolidation of certain Baker Oil Tools manufacturing operations. Cash provisions of the charge totaled $14.3 million. The Company spent $4.2 million in 1996, $6.3 million in 1997 and expects to spend the remaining $3.8 million in 1998.

NOTE 6
INDEBTEDNESS

Long-term debt consists of the following:

	1997	1996
Commercial Paper with an average interest rate of 5.5% at September 30, 1997	$ 74.0	$ 44.0
Revolving Credit Facilities due through 1999 with an average interest rate of 6.39% at September 30, 1997	90.8	33.0
Liquid Yield Option Notes ("LYONS") due May 2008 with a yield to maturity of 3.5% per annum, net of unamortized discount of $121.9 ($131.3 in 1996)	263.3	253.9
7.625% Notes due February 1999 with an effective interest rate of 7.73%, net of unamortized discount of $.4 ($.7 in 1996)	149.6	149.3
8% Notes due May 2004 with an effective interest rate of 8.08%, net of unamortized discount of $.9 ($1.1 in 1996)	99.1	98.9
Debentures with an effective interest rate of 8.59%, due January 2000	93.0	93.0
Other	2.1	1.7
Total debt	771.9	673.8
Less current maturities	0.1	0.2
Long-term debt	$ 771.8	$ 673.6

At September 30, 1997, the Company had $639.3 million of credit facilities with commercial banks, of which $300.0 million is committed. The committed facilities expire in 1999. The Company's policy is to classify commercial paper and borrowings under revolving credit facilities as long-term debt since the Company has the ability under certain credit agreements, and the intent, to maintain these obligations for longer than one year. These facilities are subject to normal banking terms and conditions and do not materially restrict the Company's activities.

The LYONS are convertible into the Company's common stock at a conversion price of $37.35 per share, calculated as of November 5, 1997, and increases at an annual rate of 3.5%. At the option of the Company, the LYONS may be redeemed for cash at any time on or after May 5, 1998, at a redemption price equal to the issue price plus accrued original issue discount through the date of redemption. At the option of the holder, the LYONS may be redeemed for cash on May 5, 1998, or on May 5, 2003, for a redemption price equal to the issue price plus accrued original issue discount through the date of redemption. The Company does not expect that the holders will redeem the LYONS for cash in May 1998 as long as the Company's common stock trades at levels above the conversion price.

Maturities of long-term debt for the next five years are as follows: 1998-$.1 million; 1999-$315.0 million; 2000-$93.5 million; 2001-$.9 million and 2002-$.1 million.

NOTE 7
FINANCIAL INSTRUMENTS

At September 30, 1997, the Company had two interest rate swap agreements for notional amounts of $93.0 million and $230.5 million maturing January 27, 2000 and May 5, 1998, respectively. These swaps effectively exchange a weighted average fixed interest rate of 5.0% for variable interest rates on the notional amount. The variable interest rate is six-month LIBOR plus 2% and 30-day commercial paper rates minus 1.96% on notional amounts of $93.0 million and $230.5 million, respectively. The interest rate swaps settle semi-annually with respect to the $93.0 million notional amount and upon maturity with respect to the $230.5 million notional amount. At September 30, 1997 and 1996, the Company had recorded an asset of $2.6 million and $3.3 million, respectively, related to the interest rate swap agreements. In the unlikely event that the counterparties fail to meet the terms of an interest rate swap agreement, the Company's exposure is limited to the interest rate differential.

Except as described below, the estimated fair values of the Company's financial instruments at September 30, 1997 and 1996 approximate their carrying value as reflected in the consolidated statements of financial position. The Company's financial instruments include cash and short-term investments, receivables, investments, payables, debt and interest rate and foreign currency contracts. The fair value of such financial instruments has been estimated based on quoted market prices and the Black-Scholes option-pricing model.

The estimated fair value of the Company's debt, at September 30, 1997 and 1996 was $864.4 million and $704.8 million, respectively, which differs from the carrying amounts of $781.4 million and $675.5 million, respectively, included in the consolidated statements of financial position. The fair value of the Company's interest rate swap contracts at September 30, 1997 and 1996 was $2.7 million and $.1 million, respectively.

NOTE 8
EMPLOYEE STOCK PLANS

The Company has stock option plans that provide for granting of options for the purchase of common stock to directors, officers and other key employees. These stock options may be granted subject to terms ranging from one to ten years at a price equal to the fair market value of the stock at the date of grant. Options vest 20% on the date of grant and 20% on each of the next four anniversaries of the grant date. All outstanding but unvested options will vest immediately if the price of the Company's common stock as traded on the New York Stock Exchange reaches $50 and averages $50 for a period of ten consecutive trading days. In connection with the acquisitions of Petrolite and Drilex, the Company assumed the outstanding employee stock options of those companies.

Stock option activity for the Company was as follows:

(Shares in thousands)	Number of Shares	Weighted Average Exercise Price Per Share
Outstanding at September 30, 1994	4,879	$ 22.90
Granted	1,349	19.13
Exercised	(153)	14.93
Forfeited	(1,060)	23.57
Outstanding at September 30, 1995	5,015	22.02
Granted	1,145	19.67
Exercised	(1,774)	22.17
Forfeited	(203)	22.23
Outstanding at September 30, 1996	4,183	21.30
Granted	899	36.13
Options assumed in acquisitions	1,017	17.89
Exercised	(2,121)	20.82
Forfeited	(104)	23.83
Outstanding at September 30, 1997	**3,874**	**$ 24.03**

The fair market value of options granted in 1997 and 1996 using the Black-Scholes option-pricing model was $10.97 and $4.71 respectively, using the following assumptions: dividend yield of 1.3% and 2.3%; expected volatility of 34.7% and 28.3%; risk-free interest rate of 5.85% and 5.78% and expected life of each option of 3.75 years and 3.75 years.

The following table summarizes information for stock options outstanding at September 30, 1997 (shares in thousands):

	Outstanding			Exercisable	
Range of Exercise Prices	Shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
$ 36.00 - 41.94	914	8.63	$36.35	202	$36.66
23.88 - 34.50	281	3.55	26.72	276	26.63
19.13 - 23.00	2,244	6.91	20.29	1,161	20.83
13.75 -17.98	435	0.87	15.70	431	15.71
Total	3,874	6.39	$24.03	2,070	$22.08

At September 30, 1997, 1.6 million shares were available for future option grants.

The Company has an Employee Stock Purchase Plan (the "Plan") under which 1.2 million shares of the Company's common stock remain authorized and available for sale to employees at a discount of 15%. Based on the market price of common stock on the date of grant, the Company estimates that 463,000 shares will be purchased in July 1998. Under the Plan, 394,000, 427,000 and 414,000 shares were issued at $24.97, $18.81 and $17.96 per share during 1997, 1996 and 1995, respectively.

Assuming the Company had used the fair market value method of accounting for its stock based compensation plans, pro forma net income and net income per share would have been $86.4 million and $.56 per share in 1997 and $171.2 million and $1.19 per share in 1996. The effects of applying the fair market value method of accounting in the above pro forma disclosure may not be indicative of future amounts since the pro forma disclosure does not apply to options granted prior to 1996, and additional awards in future years are anticipated.

NOTE 9
INCOME TAXES

The geographical sources of income before income taxes and cumulative effect of accounting changes are as follows:

	1997	1996	1995
United States	$ 20.6	$ 116.4	$ 128.3
Foreign	192.5	182.5	76.8
Total	$ 213.1	$ 298.9	$ 205.1

The provision for income taxes is as follows:

	1997	1996	1995
Current:			
United States	$ 46.5	$ 40.1	$ 3.7
Foreign	64.3	52.2	36.6
Total current	110.8	92.3	40.3
Deferred:			
United States	(.2)	20.7	42.1
Foreign	(6.6)	9.5	2.7
Total deferred	(6.8)	30.2	44.8
Provision for income taxes	$ 104.0	$ 122.5	$ 85.1

The provision for income taxes differs from the amount computed by applying the U.S. statutory income tax rate to income before income taxes and cumulative effect of accounting changes for the reasons set forth below:

	1997	1996	1995
Statutory income tax	$ 74.6	$ 104.6	$ 71.8
Nondeductible acquired in-process research and development charge	41.3		
Incremental effect of foreign operations	(6.5)	12.5	24.8
1992 and 1993 IRS audit agreement	(11.4)		
Nondeductible goodwill amortization	4.5	5.4	4.2
State income taxes - net of U.S. tax benefit	2.9	2.1	1.0
Operating loss and credit carryforwards	(4.2)	(3.3)	(13.1)
Other-net	2.8	1.2	(3.6)
Provision for income taxes	$ 104.0	$ 122.5	$ 85.1

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes, and operating loss and tax credit carryforwards. The tax effects of the Company's temporary differences and carryforwards are as follows:

	1997	1996
Deferred tax liabilities:		
Property	$ 90.6	$ 62.3
Other assets	147.5	57.7
Excess costs arising from acquisitions	67.6	64.0
Undistributed earnings of foreign subsidiaries	41.3	41.3
Other	36.5	37.4
Total	383.5	262.7
Deferred tax assets:		
Receivables	2.8	4.1
Inventory	72.4	72.4
Employee benefits	21.5	44.0
Other accrued expenses	40.6	20.2
Operating loss carryforwards	9.0	16.6
Tax credit carryforwards	15.9	30.8
Other	34.9	15.9
Subtotal	197.1	204.0
Valuation allowance	(5.7)	(13.1)
Total	191.4	190.9
Net deferred tax liability	$ 192.1	$ 71.8

A valuation allowance is recorded when it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of the deferred tax assets depends on the ability to generate sufficient taxable income of the appropriate character in the future. The Company has reserved the operating loss carryforwards in certain non-U.S. jurisdictions where its operations have decreased, currently ceased or the Company has withdrawn entirely.

Provision has been made for U.S. and additional foreign taxes for the anticipated repatriation of certain earnings of foreign subsidiaries of the Company. The Company considers the undistributed earnings of its foreign subsidiaries above the amounts already provided to be permanently reinvested. These additional foreign earnings could become subject to additional tax if remitted, or deemed remitted, as a dividend; however, the additional amount of taxes payable is not practicable to estimate.

At September 30, 1997, the Company had approximately $15.9 million of foreign tax credits expiring in varying amounts between 1998 and 2001 available to offset future payments of U.S. federal income taxes.

NOTE 10
SEGMENT AND RELATED INFORMATION

The Company adopted SFAS No. 131, *Disclosures About Segments of an Enterprise and Related Information*, in 1997 which changes the way the Company reports information about its operating segments. The information for 1996 and 1995 has been restated from the prior year's presentation in order to conform to the 1997 presentation.

The Company's nine business units have separate management teams and infrastructures that offer different products and services. The business units have been aggregated into three reportable segments (oilfield, chemicals and process equipment) since the long-term financial performance of these reportable segments is affected by similar economic conditions.

Oilfield: This segment consists of five business units - Baker Hughes INTEQ, Baker Oil Tools, Baker Hughes Solutions, Centrilift and Hughes Christensen - that manufacture and sell equipment and provide services and solutions used in the drilling, completion, production and maintenance of oil and gas wells. The principle markets for this segment include all major oil and gas producing regions of the world including North America, Latin America, Europe, Africa and the Far East. Customers include major multi-national, independent and national or state-owned oil companies.

Chemicals: Baker Petrolite is the sole business unit reported in this segment. They manufacture specialty chemicals for inclusion in the sale of integrated chemical technology solutions for petroleum production, transportation and refining. The principle geographic markets for this segment include all major oil and gas producing regions of the world. This segment also provides chemical technology solutions to other industrial markets throughout the world including petrochemicals, steel, fuel additives, plastics, imaging and adhesives. Customers include major multi-national, independent and national or state-owned oil companies as well as other industrial manufacturers.

Process Equipment: This segment consists of three business units - EIMCO Process Equipment, Bird Machine Company and Baker Hughes Process Systems - that manufacture and sell process equipment for separating solids from liquids and liquids from liquids through filtration, sedimentation, centrifugation and floatation processes. The principle markets for this segment include all regions of the world where there are significant industrial and municipal wastewater applications and base metals activity. Customers include municipalities, contractors, engineering companies and pulp and paper, minerals, industrial and oil and gas producers.

The accounting policies of the reportable segments are the same as those described in Note 1 of Notes to Consolidated Financial Statements. The Company evaluates the performance of its operating segments based on income before income taxes, accounting changes, nonrecurring items and interest income and expense. Intersegment sales and transfers are not significant.

Summarized financial information concerning the Company's reportable segments is shown in the following table. The "Other" column includes corporate related items, results of insignificant operations and, as it relates to segment profit(loss), income and expense not allocated to reportable segments.

	Oilfield	Chemicals	Process Equipment	Other	Total
1997					
Revenues	$ 2,862.6	$ 417.2	$ 386.1	$ 19.5	$ 3,685.4
Segment profit (loss)	416.8	41.9	36.3	(281.9)	213.1
Total assets	3,014.3	1,009.5	363.7	368.8	4,756.3
Capital expenditures	289.7	24.8	6.4	21.8	342.7
Depreciation and amortization	143.2	20.5	8.4	4.1	176.2
1996					
Revenues	$ 2,397.9	$ 247.6	$ 352.8	$ 29.4	$ 3,027.7
Segment profit (loss)	329.1	23.3	31.2	(84.7)	298.9
Total assets	2,464.6	270.3	258.9	303.6	3,297.4
Capital expenditures	157.5	16.6	6.6	1.5	182.2
Depreciation and amortization	123.6	12.2	6.7	3.0	145.5
1995					
Revenues	$ 2,072.2	$ 223.7	$ 319.6	$ 22.0	$ 2,637.5
Segment profit (loss)	249.6	17.8	29.7	(92.0)	205.1
Total assets	2,423.7	259.8	187.3	295.8	3,166.6
Capital expenditures	119.1	11.0	5.0	3.8	138.9
Depreciation and amortization	123.9	12.4	5.4	2.4	144.1

The following table presents the details of "Other" segment profit(loss).

	1997	1996	1995
Corporate expenses	$ (44.3)	$ (40.2)	$ (39.7)
Interest expense-net	(46.8)	(52.1)	(50.8)
Unusual charge	(52.1)	(39.6)	
Acquired in-process research and development	(118.0)		
Nonrecurring charge to cost of sales for Petrolite inventories	(21.9)		
Gain on sale of Varco stock		44.3	
Other	1.2	2.9	(1.5)
Total	$ (281.9)	$ (84.7)	$ (92.0)

The following table presents revenues by country based on the location of the use of the product or service.

	1997	1996	1995
United States	$ 1,319.7	$ 1,047.2	$ 972.9
United Kingdom	288.0	277.9	207.6
Venezuela	244.2	160.0	122.7
Canada	204.5	165.1	157.5
Norway	175.0	145.6	104.2
Indonesia	128.0	92.7	54.5
Nigeria	83.5	64.1	33.5
Oman	77.2	56.8	45.7
Other (approximately 60 countries)	1,165.3	1,018.3	938.9
Total	$ 3,685.4	$ 3,027.7	$ 2,637.5

The following table presents property by country based on the location of the asset.

	1997	1996	1995
United States	$ 593.3	$ 359.9	$ 353.0
United Kingdom	145.3	77.7	67.6
Venezuela	33.3	25.1	19.0
Germany	21.4	19.3	18.4
Norway	20.0	10.9	11.3
Canada	16.9	9.1	8.0
Singapore	11.7	17.7	25.0
Other countries	141.0	79.3	72.8
Total	$ 982.9	$ 599.0	$ 575.1

NOTE 11
EMPLOYEE BENEFIT PLANS

Postretirement Benefits Other Than Pensions

The Company provides postretirement health care benefits for substantially all U.S. employees.

The following table sets forth the funded status and amounts recognized in the Company's consolidated statements of financial position:

	1997	1996
Accumulated postretirement benefit obligation ("APBO"):		
Retirees	$ (81.1)	$ (70.8)
Fully eligible active plan participants	(11.7)	(10.0)
Other active plan participants	(17.1)	(16.6)
Total	(109.9)	(97.4)
Unrecognized net gain	(11.1)	(9.8)
Accrued postretirement benefit cost	$(121.0)	$(107.2)

Postretirement benefit expense includes the following components:

	1997	1996	1995
Cost of benefits earned	$ 1.2	$ 1.1	$ 1.3
Interest cost on APBO	7.3	7.1	8.2
Postretirement benefit expense	$ 8.5	$ 8.2	$ 9.5

The assumed health care cost trend rate used in measuring the APBO as of September 30, 1997 was 7.0% for 1998 declining gradually each successive year until it reaches 5% in 2002, after which it remains constant. A 1% increase in the trend rate for health care costs would have increased the APBO as of September 30, 1997 by 5% and the aggregate of the service and interest cost components of the 1997 net periodic postretirement benefit expense by 5%. The assumed discount rate used in determining the APBO was 7.5%.

Defined Benefit Pension Plans

The Company has several noncontributory defined benefit pension plans covering various domestic and foreign employees, including an overfunded plan acquired as part of the acquisition of Petrolite. Generally, the Company makes annual contributions to the plans in amounts necessary to meet minimum governmental funding requirements.

Net pension expense includes the following components:

	1997	1996	1995
Cost of benefits earned	$ 1.8	$ 1.4	$ 1.4
Interest cost on projected benefit obligation	4.2	2.5	2.4
Actual return on assets	(11.1)	(6.6)	(4.8)
Net amortization and deferral	5.2	3.7	2.4
Net pension expense	$ .1	$ 1.0	$ 1.4

The weighted average assumptions used in the accounting for the defined benefit plans were:

	1997	1996	1995
Discount rate	7.3%	7.1%	7.3%
Rates of increase in compensation levels	3.0%	3.0%	3.0%
Expected long-term rate of return on assets	8.9%	8.6%	8.5%

The following table sets forth the funded status and amounts recognized in the Company's consolidated statements of financial position.

	1997		1996	
	Overfunded Plans	Underfunded Plans	Overfunded Plans	Underfunded Plans
Actuarial present value of benefit obligations:				
Vested benefit obligation	$ (101.9)	$ (16.8)	$ (25.2)	$ (9.9)
Accumulated benefit obligation	(102.7)	(18.1)	(25.7)	(10.8)
Projected benefit obligation	(106.3)	(20.7)	(28.1)	(12.9)
Plan assets at fair value	205.0	4.7	37.9	3.2
Projected benefit obligation (in excess of) less than plan assets	98.7	(16.0)	9.8	(9.7)
Unrecognized prior service cost	0.3		0.5	
Unrecognized net (gain) loss	(11.0)	1.8	(5.3)	1.1
Unrecognized net (asset) liability at transition	(0.3)	0.4		0.3
Prepaid pension cost (pension liability)	$ 87.7	$ (13.8)	$ 5.0	$ (8.3)

Pension plan assets are primarily mortgages, private placements, bonds and common stocks.

Thrift Plan

Virtually all U.S. employees not covered under one of the Company's pension plans are eligible to participate in the Company sponsored Thrift Plan. The Thrift Plan allows eligible employees to contribute from 2% to 15% of their salaries to an investment trust. Employee contributions are matched by the Company at the rate of $1.00 per $1.00 employee contribution for the first 2% and $.50 per $1.00 employee contribution for the next 4% of the employee's salary. In addition, the Company contributes for all eligible employees between 2% and 5% of their salary depending on the employee's age as of January 1 each year. Such contributions become fully vested to the employee after five years of employment. The Company's contribution to the Thrift Plan and other defined contribution plans totaled $35.9 million, $30.0 million and $27.5 million in 1997, 1996 and 1995, respectively.

Postemployment Benefits

The Company provides certain postemployment benefits to substantially all former or inactive U.S. employees following employment but before retirement. Disability income benefits ("Disability Benefits"), available at the date of hire, are provided through a qualified plan which has been funded by contributions from the Company and employees. The primary asset of the plan is a guaranteed insurance contract with an insurance company which currently earns interest at 7%. The actuarially determined obligation is calculated at a discount rate of 7%. Disability Benefits expense was $1.1 million in 1997 and Disability Benefits income was $.1 million and $1.5 million in 1996 and 1995, respectively.

The continuation of medical, life insurance and Thrift Plan benefits while on disability and service related salary continuance benefits ("Continuation Benefits") were provided through a nonqualified, unfunded plan until April 1997. The continuation of the medical benefit portion of the plan was merged into the disability income benefits plan beginning in April 1997. Expense for Continuation Benefits include the following components:

	1997	1996	1995
Cost of benefits earned	$ 1.2	$ 1.0	$ 1.0
Interest cost on projected benefit obligation	2.1	1.9	1.8
Postemployment benefit expense	$ 3.3	$ 2.9	$ 2.8

The following table sets forth the funded status and amounts recognized in the Company's consolidated statements of financial position for Disability Benefits and Continuation Benefits:

	1997	1996
Actuarial present value of accumulated benefit obligation	$ (39.9)	$ (40.1)
Plan assets at fair value	15.8	18.6
Accumulated benefit obligation in excess of plan assets	(24.1)	(21.5)
Unrecognized net loss	5.6	3.2
Postemployment liability	$ (18.5)	$ (18.3)

Health care cost assumptions used to measure the Continuation Benefits obligation are similar to the assumptions used in determining the obligation for postretirement health care benefits. Additional assumptions used in the accounting for Continuation Benefits in 1997 and 1996 were a discount rate of 7% and increases in compensation of 5%.

NOTE 12
STOCKHOLDER RIGHTS AGREEMENT AND OTHER MATTERS

The Company had a Stockholder Rights Agreement ("SRA") to protect against coercive takeover tactics. During 1996, the Company exercised its option to redeem all of the rights to purchase from the Company .01 of a share of the Series One Junior Participating Preferred Stock for the redemption price of $.03 per right in accordance with the SRA. The cash distribution of $.115 per share of common stock in the third quarter of 1996 includes the redemption price.

Supplemental consolidated statement of operations information is as follows:

	1997	1996	1995
Rental expense (generally transportation equipment and warehouse facilities)	$ 42.5	$ 41.5	$ 37.0
Research and development	59.5	44.0	37.4
Income taxes paid	96.0	78.1	49.3
Interest paid	39.4	49.6	45.2

At September 30, 1997, the Company had long-term operating leases covering certain facilities and equipment on which minimum annual rental commitments for each of the five years in the period ending September 30, 2002 are $34.8 million, $25.2 million, $17.3 million, $9.9 million and $8.2 million, respectively, and $45.2 million in the aggregate thereafter. The Company has not entered into any significant capital leases.

NOTE 13
LITIGATION

The Company is sometimes named as a defendant in litigation relating to the products and services it provides. The Company insures against these risks to the extent deemed prudent by its management, but no assurance can be given that the nature and amount of such insurance will in every case fully indemnify the Company against liabilities arising out of pending and future legal proceedings relating to its ordinary business activities.

NOTE 14
ENVIRONMENTAL MATTERS

The Company's past and present operations include activities which are subject to extensive federal and state environmental regulations.

The Company has been identified as a potentially responsible party ("PRP") in remedial activities related to various "Superfund" sites. Applicable federal law imposes joint and several liability on each PRP for the cleanup of these sites leaving the Company with the uncertainty that it may be responsible for remediation cost attributable to other PRPs who are unable to pay their share of the remediation costs. Generally, the Company has determined its share of such total cost based on the ratio that the number of gallons of waste estimated to be contributed to the site by the Company bears to the total number of gallons of waste estimated to have been disposed at the site. The Company has accrued what it believes to be its share of the total cost of remediation of these Superfund sites. No accrual has been made under the joint and several liability concept since the Company believes that the probability that it will have to pay material costs above its share is remote due to the fact that the other PRPs have substantial assets available to satisfy their obligation.

At September 30, 1997 and 1996, the Company had accrued approximately $24.6 million, and $8.3 million, respectively, for remediation costs, including the Superfund sites referred to above. The measurement of the accruals for remediation costs is subject to uncertainties, including the evolving nature of environmental regulations and the difficulty in estimating the extent and remedy of agreements that may be available to the Company to mitigate the remediation costs, such amounts have not been considered in measuring the remediation accrual.

NOTE 15
QUARTERLY DATA (UNAUDITED)

Summarized quarterly financial data is shown in the table below:

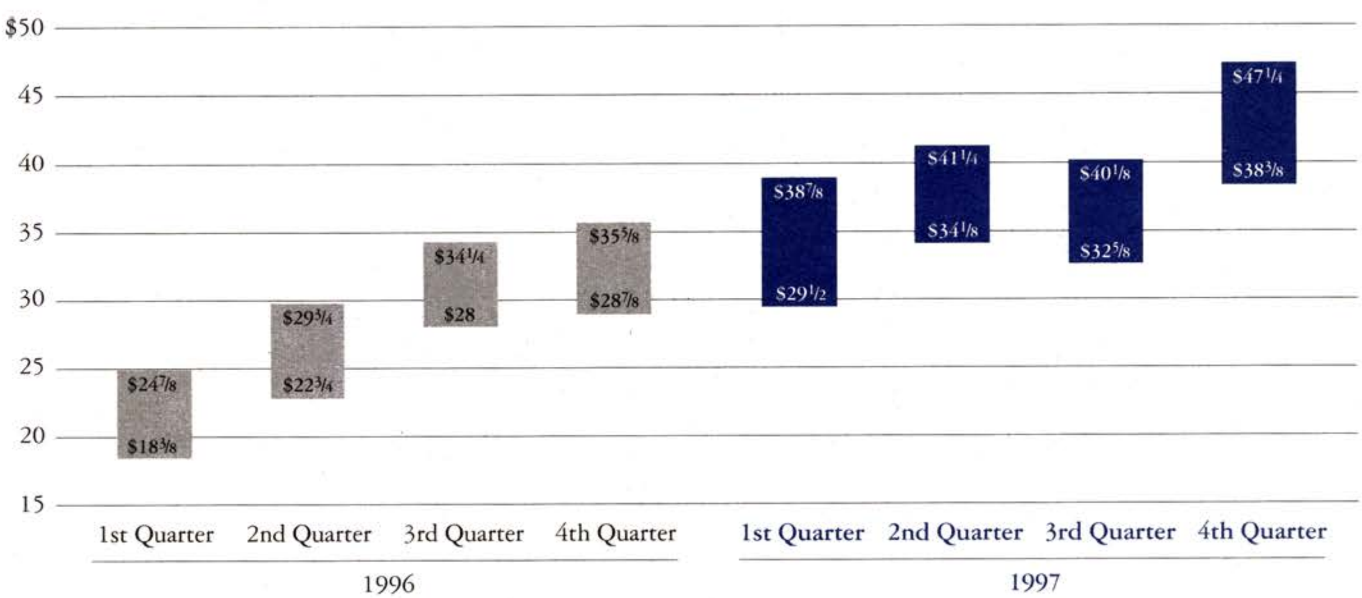
(Per share amounts in dollars)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Fiscal Year
Fiscal Year 1997: *					
Revenues	$ 826.7	$ 850.2	$ 917.3	$ 1,091.2	$ 3,685.4
Gross profit **	320.9	329.2	361.8	417.3	1,429.2
Income (loss) before cumulative effect of accounting change	51.5	58.0	82.5	(82.9)	109.1
Net income (loss)	39.4	58.0	82.5	(82.9)	97.0
Per share of common stock: ***					
Income (loss) before accounting change	.35	.39	.56	(.49)	.71
Net income (loss)	.27	.39	.56	(.49)	.63
Dividends per share	.115	.115	.115	.115	.46
Fiscal Year 1996: *					
Revenues	$ 694.7	$ 744.8	$ 765.9	$ 822.3	$ 3,027.7
Gross profit **	270.7	287.4	308.4	323.6	1,190.1
Net income	32.4	41.6	46.9	55.5	176.4
Net income per share	.23	.29	.33	.38	1.23
Dividends per share	.115	.115	.115	.115	.46

* *See Notes 1, 4 and 5 for information regarding accounting changes, acquisitions and dispositions and unusual charges, respectively.*

** *Represents revenues less costs of sales and costs of services and rentals.*

*** *Quarterly per share amounts do not sum to the fiscal year amount because of the issuance of 22.0 million shares of common stock in July 1997.*

Stock Prices by Quarter



CORPORATE ORGANIZATION

Corporate Officers:

Max L. Lukens
Chairman, President and
Chief Executive Officer

Eric L. Mattson
Senior Vice President and
Chief Financial Officer

G. Stephen Finley
Senior Vice President and
Chief Administrative Officer

Andrew J. Szescila
Senior Vice President and President,
Baker Hughes Oilfield Operations

David H. Barr
Vice President, Business Process
Development

Arthur T. Downey
Vice President, Government Affairs

R. Pat Herbert
Vice President,
Technology & Market Development

Lawrence O'Donnell, III
Vice President and General Counsel

James E. Braun
Vice President and Contoller

James W. Harris
Vice President, Tax

Douglas C. Doty
Treasurer

Linda J. Smith
Corporate Secretary

M. Glen Bassett
Vice President and President,
Baker Petrolite Corporation

Joseph F. Brady
Vice President and President, Centrilift

Matthew G. Dick
Vice President and President, Baker
Hughes Process Equipment Company

Edwin C. Howell
Vice President and President,
Baker Oil Tools

Timothy J. Probert
Vice President and President,
Baker Hughes INTEQ

Jay P. Trahan
Vice President and President,
Baker Hughes Solutions

Douglas J. Wall
Vice President and President,
Hughes Christensen Company

Board of Directors:

Lester M. Aberthal, Jr.
Chairman and
Chief Executive Officer of EDS

Victor G. Beghini
Vice Chairman - Marathon Group,
USX Corporation and President,
Marathon Oil Company

Jack S. Blanton*
President of Eddy Refining Company

Eunice M. Filter
Vice President, Secretary and
Treasurer of Xerox Corporation

Joe B. Foster
Chairman and Chief Executive Officer
of Newfield Exploration Company

Richard D. Kinder
Chairman and Chief Executive Officer
of Kinder Morgan Energy Partners, L.P.

Max L. Lukens
Chairman, President and Chief Executive
Officer of Baker Hughes Incorporated

John F. Maher
Retired President and
Chief Executive Officer of
Great Western Financial Corporation

James F. McCall
Lt. General, US Army (Retired),
Executive Director of the American
Society of Military Comptrollers

H. John Riley, Jr.
Chairman, President and Chief Executive
Officer of Cooper Industries, Inc.

Donald C. Trauscht*
Chairman of BW Capital Corporation

Charles L. Watson**
Chairman and Chief Executive Officer
of NGC Corporation

Max P. Watson, Jr.**
Chairman, President and Chief Executive
Officer of BMC Software, Inc.

* Will retire at the Annual Meeting
of Stockholders to be held on
January 28, 1998.

** Nominee for election as a
Class 1 director at the Annual Meeting
of Stockholders to be held on
January 28, 1998.

CORPORATE INFORMATION

Transfer Agent and Registrar
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85 Challenger Road
Ridgefield Park NJ 07660
1(888)216-8057

Independent Accountants
Deloitte & Touche LLP
Houston, Texas

Stock Exchange Listings
Ticker Symbol "BHI"
New York Stock Exchange,
Pacific Exchange, Inc.,
The Swiss Stock Exchange

Investor Relations Office
Gary R. Flaharty
Director Investor Relations
Baker Hughes Incorporated
P.O. Box 4740
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gary.flaharty@bakerhughes.com

Form 10-K
A copy of the Company's Annual Report to the Securities and Exchange Commission (Form 10-K) is available by writing to Baker Hughes Investor Relations

Annual Meeting
The Company's Annual Meeting of Stockholders will be held at 11:00 AM on January 28, 1998 at the offices of the Company: 3900 Essex Lane, Suite 210, Houston, Texas

Corporate Office Location and Mailing Address
3900 Essex Lane
Houston, Texas 77027
Telephone 713/439-8600
P.O. Box 4740
Houston, Texas 77210-4740

Website
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Baker Hughes Information System
1-800-969-7447

GLOSSARY *A glossary of selected oilfield terms*

Acoustic activation - actuation of downhole tools through the use of sound waves.

Coiled tubing drilling - a method in which long lengths of small diameter (<3-1/2") tubing are kept on a spool and used to drill, re-enter and workover a well.

Completion - technology used to bring a well on production. Matched to the reservoir and formation for optimum production, completion technology includes perforating, gravel packing and flow control equipment (such as packers, inflatable tools and sliding sleeves).

Deepwater - drilling in water depths which exceed 1500'.

Directional drilling - the method of guiding a well along a pre-determined path to a specific target. A directional drilling company provides technology and rig site supervision to efficiently meet directional drilling objectives.

Downhole factory - a Baker Hughes concept for the future in which many tasks associated with hydrocarbon production are performed in the wellbore instead of on the surface. Downhole oil/water separation and automated well maintenance are examples.

Downhole oil/water separation - a system comprising a downhole hydrocyclone and electrical submersible pump that separates oil from water downhole, reinjects water and produces oil to the surface.

Drill-in fluid - a specialty drilling fluid designed to minimize formation damage in the reservoir.

Drilling fluid - fluid used in the wellbore to lubricate and cool the bit, control bottomhole pressures and remove cuttings.

Electrical submersible pump (ESP) - a system comprised of a downhole pump, a downhole electric motor, cabling and surface controller to lift large quantities of fluids from wells which do not flow under their own pressure.

Fishing - tools and services that perform specialty and repair work downhole. Fishing activities include retrieving lost tools and repairing wellbore damage.

Flow control - completion equipment used to control the flow of production downhole.

Geosteering - a subset of horizontal drilling in which measurements of formation properties are used to place the wellbore in specific geologic targets.

gravel pack - a completion technique used to control production of sand from loosely consolidated formations

Horizontal drilling - a subset of directional drilling in which the angle of deviation of the wellbore reaches 90 degrees, maximizing the length of wellbore exposed to the formation.

Hydrocyclone - a device for separating mixed liquids (e.g. oil and water).

Integrated solutions - a method of supplying a comprehensive offering of project management, products and services which improves project efficiency for the oil company customer. Integrated solutions contracts typically place more responsibility on the service integrator in exchange for incentives payable when project goals are achieved.

Intelligent completions - a completion technology in which formation property measurements are made and the completion dynamically adjusts itself to maximize production from the well.

Logging-while-drilling (LWD) - a variation of measurement-while-drilling in which the LWD tool gathers information about the formation while the well is being drilled.

Measurement-while-drilling (MWD) - measuring directional information (azimuth, inclination, and tool orientation) downhole to adjust the drilling process and guide the wellbore to a specific target.

Mud motor - a downhole motor used to turn a bit by converting the flow of drilling fluid into rotational energy.

Multilateral well - a well in which two or more branches are drilled from a single main wellbore. Various levels of completion systems can be installed in a multilateral well to enable it to produce from several zones simultaneously.

Oilfield chemicals - chemicals used to treat produced fluids and control corrosion and deposition in producing wells.

Packer - open and cased hole devices used to create seals to control fluid flow.

PDC drill bits - use fixed position polycrystalline diamond compact cutters that shear the formation instead of grinding it. In many applications, PDC bits offer higher penetration rates and longer life than tri-cone bits.

Resistivity - a measurement of a formation's resistance to electrical current. Used to determine whether the formation holds hydrocarbons or water.

Sidetrack - a new well section drilled from an existing well to avoid a problem zone or reach a target of opportunity.

Sliding sleeve - a flow control device which can be opened or closed to allow or prevent production to flow into the well.

Tricone drill bit - a rotary drill bit employing 3 cones and either hardened steel teeth or tungsten carbide inserts (TCI). This bit works by grinding away at formation rock as it is turned.

Workover- maintenance procedures performed on a previously - completed well to restore or stimulate production or increase the life of a well.

Zone - one or more sections of wellbore partitioned by downhole tools for the purpose of isolating production.

Designed and produced by Pegasus Design, Inc., Houston, Texas
Photography by James LaCombe

BAKER HUGHES