HALLIBURTON CO
Form 10-Q
July 27, 2007

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

[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2007

OR

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

Commission File Number 1-3492

HALLIBURTON COMPANY

(a Delaware Corporation)
75-2677995

5 Houston Center
1401 McKinney, Suite 2400
Houston, Texas 77010
(Address of Principal Executive Offices)

Telephone Number – Area Code (713) 759-2600

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated Filer	__X__	Accelerated filer	_____	Non-accelerated filer	_____

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes _____ No __X__

As of July 20, 2007, 890,164,956 shares of Halliburton Company common stock, $2.50 par value per share, were outstanding.

HALLIBURTON COMPANY

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

HALLIBURTON COMPANY
Condensed Consolidated Statements of Operations
(Unaudited)

	Three Months Ended June 30		Six Months Ended June 30	
Millions of dollars and shares except per share data	2007	2006	2007	2006
Revenue:				
Services	$ 2,744	$ 2,312	$ 5,266	$ 4,507
Product sales	991	804	1,891	1,547
Total revenue	3,735	3,116	7,157	6,054
Operating costs and expenses:				
Cost of services	1,980	1,630	3,797	3,187
Cost of sales	829	654	1,578	1,267
General and administrative	82	73	151	159
Gain on sale of business assets, net	(49)	(1)	(50)	(11)
Total operating costs and expenses	2,842	2,356	5,476	4,602
Operating income	893	760	1,681	1,452
Interest expense	(41)	(42)	(79)	(84)
Interest income	36	35	74	58
Other, net	(2)	(1)	(5)	1
Income from continuing operations before income taxes and minority interest	886	752	1,671	1,427
Provision for income taxes	(284)	(245)	(543)	(468)
Minority interest in net income of subsidiaries	(7)	(9)	(4)	(12)
Income from continuing operations	595	498	1,124	947
Income from discontinued operations, net of income tax (provision) benefit of $19, $(27), $(11), and $(62)	935	93	958	132
Net income	$ 1,530	$ 591	$ 2,082	$ 1,079
Basic income per share:				
Income from continuing operations	$ 0.66	$ 0.49	$ 1.18	$ 0.92
Income from discontinued operations, net	1.03	0.09	1.01	0.13
Net income per share	$ 1.69	$ 0.58	$ 2.19	$ 1.05
Diluted income per share:				
Income from continuing operations	$ 0.63	$ 0.47	$ 1.14	$ 0.89
Income from discontinued operations, net	0.99	0.08	0.98	0.12
Net income per share	$ 1.62	$ 0.55	$ 2.12	$ 1.01
Cash dividends per share	$ 0.09	$ 0.075	$ 0.165	$ 0.15
Basic weighted average common shares outstanding	905	1,026	949	1,025
Diluted weighted average common shares outstanding	942	1,070	983	1,069

See notes to condensed consolidated financial statements.

HALLIBURTON COMPANY
Condensed Consolidated Balance Sheets
(Unaudited)

Millions of dollars and shares except per share data	June 30, 2007	December 31, 2006
Assets		
Current assets:		
Cash and equivalents	$ 1,348	$ 2,918
Receivables (less allowance for bad debts of $51 and $40)	2,948	2,629
Inventories	1,500	1,235
Investments in marketable securities	875	20
Current deferred income taxes	217	205
Current assets of discontinued operations	–	3,898
Other current assets	384	285
Total current assets	7,272	11,190
Property, plant, and equipment, net of accumulated depreciation of $3,910 and $3,793	2,988	2,557
Goodwill	594	486
Noncurrent deferred income taxes	430	448
Noncurrent assets of discontinued operations	–	1,497
Other assets	705	682
Total assets	$ 11,989	$ 16,860
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 856	$ 655
Accrued employee compensation and benefits	447	496
Income tax payable	215	146
Deferred revenue	198	171
Current maturities of long-term debt	11	26
Current liabilities of discontinued operations	–	2,831
Other current liabilities	439	409
Total current liabilities	2,166	4,734
Long-term debt	2,784	2,783
Employee compensation and benefits	491	474
Noncurrent liabilities of discontinued operations	–	981
Other liabilities	619	443
Total liabilities	6,060	9,415
Minority interest in consolidated subsidiaries	71	69
Shareholders' equity:		
Common shares, par value $2.50 per share – authorized 2,000 shares, issued 1,061 and 1,060 shares	2,653	2,650
Paid-in capital in excess of par value	1,662	1,689
Accumulated other comprehensive income (loss)	(178)	(437)
Retained earnings	6,942	5,051
	11,079	8,953
Less 171 and 62 shares of treasury stock, at cost	5,221	1,577
Total shareholders' equity	5,858	7,376
Total liabilities and shareholders' equity	$ 11,989	$ 16,860

See notes to condensed consolidated financial statements.

HALLIBURTON COMPANY
Condensed Consolidated Statements of Cash Flows
(Unaudited)

Millions of dollars	Six Months Ended June 30 2007	2006
Cash flows from operating activities:		
Net income	$ 2,082	$ 1,079
Adjustments to reconcile net income to net cash from operations:		
Income from discontinued operations	(958)	(132)
Depreciation, depletion, and amortization	271	234
Provision (benefit) for deferred income taxes, including $(15) and $(4) related to discontinued operations	(5)	371
Gain on sale of assets	(50)	(20)
Other changes:		
Receivables	(225)	(187)
Inventories	(263)	(164)
Accounts payable	158	36
Contributions to pension plans	(22)	(49)
Other	93	(97)
Cash flows from continuing operations	1,081	1,071
Cash flows from discontinued operations	(56)	(5)
Total cash flows from operating activities	1,025	1,066
Cash flows from investing activities:		
Capital expenditures	(682)	(339)
Sales of property, plant, and equipment	84	64
Dispositions (acquisitions) of business assets, net of cash acquired or disposed	(125)	7
Sales (purchases) of short-term investments in marketable securities, net	(842)	–
Investments – restricted cash	49	–
Other investing activities	(13)	(6)
Cash flows from continuing operations	(1,529)	(274)
Cash flows from discontinued operations	(13)	238
Total cash flows from investing activities	(1,542)	(36)
Cash flows from financing activities:		
Proceeds from exercises of stock options	53	117
Payments to reacquire common stock	(926)	(190)
Borrowings (repayments) of short-term debt, net	(1)	(10)
Payments of long-term debt	(2)	(48)
Payments of dividends to shareholders	(157)	(155)
Tax benefit from exercise of options and restricted stock	15	–
Other financing activities	(1)	(2)
Cash flows from continuing operations	(1,019)	(288)
Cash flows from discontinued operations	(18)	9
Total cash flows from financing activities	(1,037)	(279)
Effect of exchange rate changes on cash	(16)	(9)
Increase (decrease) in cash and equivalents	(1,570)	742
Cash and equivalents at beginning of period	2,918	2,001
Cash and equivalents at end of period	$ 1,348	$ 2,743
Supplemental disclosure of cash flow information:		

Cash payments during the period for:				
Interest from continuing operations	$	72	$	84
Income taxes from continuing operations	$	528	$	127

See notes to condensed consolidated financial statements.

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HALLIBURTON COMPANY
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Note 1. Basis of Presentation and Description of Company

The accompanying unaudited condensed consolidated financial statements were prepared using generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Regulation S-X. Accordingly, these financial statements do not include all information or footnotes required by generally accepted accounting principles for annual financial statements and should be read together with our 2006 Annual Report on Form 10-K.

Certain prior period amounts have been reclassified to be consistent with the current presentation.

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

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

Ultimate results could differ from our estimates.

In our opinion, the condensed consolidated financial statements included herein contain all adjustments necessary to present fairly our financial position as of June 30, 2007, the results of our operations for the three and six months ended June 30, 2007 and 2006, and our cash flows for the six months ended June 30, 2007 and 2006. Such adjustments are of a normal recurring nature. The results of operations for the three and six months ended June 30, 2007 may not be indicative of results for the full year.

KBR, Inc. (KBR) has been reclassified to discontinued operations in the condensed consolidated financial statements. All prior periods have been restated to reflect this reclassification.

Note 2. KBR, Inc. Separation

In November 2006, KBR completed an initial public offering (IPO), in which it sold approximately 32 million shares of KBR, Inc. common stock at $17.00 per share. Proceeds from the IPO were approximately $508 million, net of underwriting discounts and commissions and offering expenses. The increase in the carrying amount of our investment in KBR, Inc., resulting from the IPO, was recorded in “Paid-in capital in excess of par value” on our condensed consolidated balance sheet at December 31, 2006. On April 5, 2007, we completed the separation of KBR from us by exchanging the 135.6 million shares of KBR, Inc. common stock owned by us on that date for 85.3 million shares of our common stock. In the second quarter of 2007, we recorded a gain on the disposition of KBR, Inc. of approximately $933 million, net of tax and the estimated fair value of the indemnities and guarantees provided to KBR as described below, which is included in income from discontinued operations on the condensed consolidated statement of operations.

The following table presents the financial results of KBR, Inc. as discontinued operations in our condensed consolidated statements of operations. For accounting purposes, we ceased including KBR’s operations in our results effective March 31, 2007.

	Three Months Ended June 30		Six Months Ended June 30	
Millions of dollars	2007	2006	2007	2006
Revenue	$ -	$ 2,429	$ 2,250	$ 4,675
Operating income	$ -	$ (40)	$ 62	$ 22
Net income	$ -	$ 94	$ 23(a)	$ 131

(a) Net income for the six months ended June 30, 2007 represents our 81% share of KBR, Inc.’s results.

We entered into various agreements relating to the separation of KBR, including, among others, a master separation agreement, a registration rights agreement, a tax sharing agreement, transition services agreements, and an employee matters agreement. The master separation agreement provides for, among other things, KBR's responsibility for liabilities related to its business and Halliburton's responsibility for liabilities unrelated to KBR's business. Halliburton provides indemnification in favor of KBR under the master separation agreement for certain contingent liabilities, including Halliburton's indemnification of KBR and any of its greater than 50%-owned subsidiaries as of November 20, 2006, the date of the master separation agreement, for:

- fines or other monetary penalties or direct monetary damages, including disgorgement, as a result of a claim made or assessed by a governmental authority in the United States, the United Kingdom, France, Nigeria, Switzerland, and/or Algeria, or a settlement thereof, related to alleged or actual violations occurring prior to November 20, 2006 of the United States Foreign Corrupt Practices Act (FCPA) or particular, analogous applicable foreign statutes, laws, rules, and regulations in connection with investigations pending as of that date, including with respect to the construction and subsequent expansion by TSKJ of a natural gas liquefaction complex and related facilities at Bonny Island in Rivers State, Nigeria; and
- all out-of-pocket cash costs and expenses, or cash settlements or cash arbitration awards in lieu thereof, KBR may incur after the effective date of the master separation agreement as a result of the replacement of the subsea flowline bolts installed in connection with the Barracuda-Caratinga project. See Note 10 for further discussion of these matters.

Additionally, the Halliburton performance guarantees, surety bond guarantees, and letter of credit guarantees that are currently in place in favor of KBR's customers or lenders will continue until these guarantees expire at the earlier of: (1) the termination of the underlying project contract or KBR obligations thereunder or (2) the expiration of the relevant credit support instrument in accordance with its terms or release of such instrument by the customer. Further, KBR and we have agreed that, until December 31, 2009, we will issue additional guarantees, indemnification, and reimbursement commitments for KBR's benefit in connection with (a) letters of credit necessary to comply with KBR's Egypt Basic Industries Corporation ammonia plant contract, KBR's Allenby & Connaught project, and all other KBR contracts that were in place as of December 15, 2005; (b) surety bonds issued to support new task orders pursuant to the Allenby & Connaught project, two job order contracts for KBR's Government and Infrastructure segment, and all other KBR contracts that were in place as of December 15, 2005; and (c) performance guarantees in support of these contracts. KBR will compensate Halliburton for these guarantees and indemnify Halliburton if Halliburton is required to perform under any of these guarantees.

As a result of these agreements, we recorded $190 million, as a reduction of the gain on the disposition of KBR, to reflect the estimated fair value of the above indemnities and guarantees, net of the associated estimated future tax benefit.

The tax sharing agreement provides for allocations of United States income tax liabilities and other agreements between us and KBR with respect to tax matters. Under the transition services agreements, we continue to provide various interim corporate support services to KBR, and KBR continues to provide various interim corporate support services to us. The fees are determined on a basis generally intended to approximate the fully allocated direct and indirect costs of providing the services, without any profit. Under an employee matters agreement, Halliburton and KBR have allocated liabilities and responsibilities related to current and former employees and their participation in certain benefit plans. Among other items, the employee matters agreement provided for the conversion, which occurred upon completion of the separation of KBR, of stock options and restricted stock awards (with restrictions that had not yet lapsed as of the final separation date) granted to KBR employees under our 1993 Stock and Incentive Plan (1993 Plan) to options and restricted stock awards covering KBR common stock. As of April 5, 2007, these awards consisted of 1.2 million options with a weighted average exercise price per share of $15.01 and approximately 600,000 restricted shares with a weighted average grant-date fair value per share of $17.95 under our 1993 Plan.

Note 3. Acquisitions and Dispositions

Dresser, Ltd. interest

As a part of our sale of Dresser Equipment Group in 2001, we retained a small equity interest in Dresser Inc.'s Class A common stock. Dresser Inc. was later reorganized as Dresser, Ltd., and we exchanged our shares for shares of Dresser, Ltd. In May 2007, we sold our remaining interest in Dresser, Ltd. We received $70 million in cash from the sale and recorded a $49 million gain. This investment was reflected in "Other assets" on our condensed consolidated balance sheet at December 31, 2006.

Ultraline Services Corporation

In January 2007, we acquired all intellectual property, current assets, and existing business associated with Calgary-based Ultraline Services Corporation (Ultraline), a division of Savanna Energy Services Corp. Ultraline is a provider of wireline services in Canada. As of June 30, 2007, we paid approximately $176 million, subject to adjustment for working capital, and recorded goodwill of $108 million and intangible assets of $41 million. In July 2007, the working capital adjustment was finalized for an immaterial amount. Ultraline's results of operations are included in our Drilling and Formation Evaluation segment.

Note 4. Business Segment Information

We have four business segments: Production Optimization, Fluid Systems, Drilling and Formation Evaluation, and Digital and Consulting Solutions. The two KBR segments have been reclassified to discontinued operations as a result of the separation of KBR from us.

Certain indirect expenses that were previously allocated to the segments are now included in general corporate expenses. All prior period amounts have been reclassified accordingly.

The following table presents information on our business segments.

	Three Months Ended June 30		Six Months Ended June 30	
Millions of dollars	2007	2006	2007	2006
Revenue:				
Production Optimization	$ 1,533	$ 1,292	$ 2,870	$ 2,488
Fluid Systems	1,045	870	2,038	1,706
Drilling and Formation Evaluation	953	774	1,870	1,499
Digital and Consulting Solutions	204	180	379	361
Total revenue	$ 3,735	$ 3,116	$ 7,157	$ 6,054
Operating income (loss):				
Production Optimization	$ 403	$ 368	$ 728	$ 701
Fluid Systems	200	201	414	390
Drilling and Formation Evaluation	235	194	491	373
Digital and Consulting Solutions	117	51	167	101
General corporate	(62)	(54)	(119)	(113)
Total operating income	$ 893	$ 760	$ 1,681	$ 1,452

Intersegment revenue was immaterial. Our equity in earnings and losses of unconsolidated affiliates that are accounted for by the equity method is included in revenue and operating income of the applicable segment.

As of June 30, 2007, 37% of our gross trade receivables were from customers in the United States. As of December 31, 2006, 39% of our gross trade receivables were from customers in the United States. No other country accounted for more than 10% of our gross trade receivables at these dates.

Note 5. Inventories

Inventories are stated at the lower of cost or market. In the United States, we manufacture certain finished products and have parts inventories for drill bits, completion products, bulk materials, and other tools that are recorded using the last-in, first-out method totaling $72 million at June 30, 2007 and $58 million at December 31, 2006. If the weighted average cost method was used, total inventories would have been $23 million higher than reported at June 30, 2007 and $20 million higher than reported at December 31, 2006. Inventories consisted of the following:

Millions of dollars	June 30, 2007	December 31, 2006
Finished products and parts	$ 987	$ 883
Raw materials and supplies	396	256
Work in process	117	96
Total	$ 1,500	$ 1,235

Finished products and parts are reported net of obsolescence reserves of $72 million at June 30, 2007 and $63 million at December 31, 2006.

Note 6. Investments

Investments in marketable securities

At June 30, 2007, we had $875 million invested in marketable securities, consisting of auction-rate securities, variable-rate demand notes, and municipal bonds. Our auction-rate securities and variable-rate demand notes are classified as available-for-sale and recorded at fair value. Our municipal bond investments are classified as held-to-maturity and recorded at amortized cost. At December 31, 2006, our investments in marketable securities were $20 million.

Restricted and committed cash

At June 30, 2007, we had restricted cash of $59 million, which primarily consisted of collateral for potential future insurance claim reimbursements included in “Other assets.” At December 31, 2006, we had restricted cash of $108 million in “Other assets,” which primarily consisted of similar items. The $49 million decrease in restricted cash reflects the release, due to the separation of KBR, of collateral related to potential insurance claim reimbursements.

Note 7. Debt

The stock conversion rate for the $1.2 billion of 3.125% convertible senior notes issued in June 2003 changed to 53.26 in the second quarter of 2007 due to the increased quarterly dividend on the common stock.

On July 9, 2007, we entered into a new unsecured $1.2 billion five-year revolving credit facility that replaced our then existing unsecured $1.2 billion five-year revolving credit facility with generally similar terms and conditions except that the new facility does not contain any financial covenants. At June 30, 2007, we were required to maintain and were in compliance with a maximum debt-to-capitalization ratio under our then existing unsecured $1.2 billion revolving credit facility. The purpose of both the new and the replaced facility is to provide commercial paper support, general working capital, and credit for other corporate purposes. There were no cash drawings under the former facility as of June 30, 2007.

Note 8. Comprehensive Income

The components of other comprehensive income included the following:

Millions of dollars	Three Months Ended June 30 2007	Three Months Ended June 30 2006	Six Months Ended June 30 2007	Six Months Ended June 30 2006
Net income	$ 1,530	$ 591	$ 2,082	$ 1,079
Cumulative translation adjustments	1	43	–	37
Realization of (gains) losses included in net income	(24)	(19)	(24)	(16)
Net cumulative translation adjustments	(23)	24	(24)	21
Realized pension liability adjustments	271	–	282	–
Unrealized net gains (losses) on investments and derivatives	–	15	1	21
Realization of (gains) losses on investments and derivatives included in net income	–	(2)	–	–
Net unrealized gains (losses) on investments and derivatives	–	13	1	21
Total comprehensive income	$ 1,778	$ 628	$ 2,341	$ 1,121

Accumulated other comprehensive income consisted of the following:

Millions of dollars	June 30, 2007	December 31, 2006
Cumulative translation adjustments	$ (62)	$ (38)
Pension liability adjustments	(118)	(400)
Unrealized gains (losses) on investments and derivatives	2	1
Total accumulated other comprehensive income	$ (178)	$ (437)

Note 9. Asbestos Insurance Recoveries

Several of our subsidiaries or former subsidiaries, particularly DII Industries LLC and Kellogg Brown & Root LLC, had been named as defendants in a large number of asbestos- and silica-related lawsuits. Effective December 31, 2004, we resolved all open and future claims in the prepackaged Chapter 11 proceedings of DII Industries LLC, Kellogg Brown & Root LLC, and our other affected subsidiaries (which were filed on December 16, 2003) when the plan of reorganization became final and nonappealable.

During 2004, we settled insurance disputes with substantially all the insurance companies for asbestos- and silica-related claims and all other claims under the applicable insurance policies and terminated all the applicable insurance policies. Under the terms of our insurance settlements, we would receive cash proceeds with a nominal amount of approximately $1.5 billion and with a then present value of approximately $1.4 billion for our asbestos- and silica-related insurance receivables. Cash payments of approximately $24 million related to these receivables were received in the first six months of 2007. At June 30, 2007, the remaining amounts that we will receive under the terms of the settlement agreements totaled $238 million or $220 million on a present value basis, to be paid in several installments through 2010. Of the $220 million recorded at June 30, 2007, $68 million was classified as current.

Under the insurance settlements entered into as part of the resolution of our Chapter 11 proceedings, we have agreed to indemnify our insurers under certain historic general liability insurance policies in certain situations. We have concluded that the likelihood of any claims triggering the indemnity obligations is remote, and we believe any

potential liability for these indemnifications will be immaterial. At June 30, 2007, we had not recorded any liability associated with these indemnifications.

Note 10. Commitments and Contingencies

Foreign Corrupt Practices Act investigations

The Securities and Exchange Commission (SEC) is conducting a formal investigation into whether improper payments were made to government officials in Nigeria through the use of agents or subcontractors in connection with the construction and subsequent expansion by TSKJ of a multibillion dollar natural gas liquefaction complex and related facilities at Bonny Island in Rivers State, Nigeria. The Department of Justice (DOJ) is also conducting a related criminal investigation. The SEC has also issued subpoenas seeking information, which we and KBR are furnishing, regarding current and former agents used in connection with multiple projects, including current and prior projects, over the past 20 years located both in and outside of Nigeria in which the Halliburton energy services business, KBR or affiliates, subsidiaries or joint ventures of Halliburton or KBR, are or were participants. In September 2006, the SEC requested that we enter into a tolling agreement with respect to its investigation. We anticipate that we will enter into an appropriate tolling agreement with the SEC.

TSKJ is a private limited liability company registered in Madeira, Portugal whose members are Technip SA of France, Snamprogetti Netherlands B.V. (a subsidiary of Saipem SpA of Italy), JGC Corporation of Japan, and Kellogg Brown & Root LLC (a subsidiary of KBR), each of which had an approximate 25% interest in the venture. TSKJ and other similarly owned entities entered into various contracts to build and expand the liquefied natural gas project for Nigeria LNG Limited, which is owned by the Nigerian National Petroleum Corporation, Shell Gas B.V., Cleag Limited (an affiliate of Total), and Agip International B.V. (an affiliate of ENI SpA of Italy).

The SEC and the DOJ have been reviewing these matters in light of the requirements of the FCPA. In addition to performing our own investigation, we have been cooperating with the SEC and the DOJ investigations and with other investigations in France, Nigeria, and Switzerland regarding the Bonny Island project. The government of Nigeria gave notice in 2004 to the French magistrate of a civil claim as an injured party in the French investigation. We are not aware of any further developments with respect to this claim. We also believe that the Serious Fraud Office in the United Kingdom is conducting an investigation relating to the Bonny Island project. Our Board of Directors has appointed a committee of independent directors to oversee and direct the FCPA investigations. Through our committee of independent directors, we will continue to oversee and direct the investigations.

The matters under investigation relating to the Bonny Island project cover an extended period of time (in some cases significantly before our 1998 acquisition of Dresser Industries and continuing through the current time period). We have produced documents to the SEC and the DOJ both voluntarily and pursuant to company subpoenas from the files of numerous officers and employees of Halliburton and KBR, including current and former executives of Halliburton and KBR, and we are making our employees and KBR is making its employees available to the SEC and the DOJ for interviews. In addition, the SEC has issued a subpoena to A. Jack Stanley, who formerly served as a consultant and chairman of Kellogg Brown & Root LLC, and to others, including certain of our former and KBR’s current and former employees, former executive officers of KBR, and at least one subcontractor of KBR. We further understand that the DOJ has issued subpoenas for the purpose of obtaining information abroad, and we understand that other partners in TSKJ have provided information to the DOJ and the SEC with respect to the investigations, either voluntarily or under subpoenas.

The SEC and DOJ investigations include an examination of whether TSKJ’s engagements of Tri-Star Investments as an agent and a Japanese trading company as a subcontractor to provide services to TSKJ were utilized to make improper payments to Nigerian government officials. In connection with the Bonny Island project, TSKJ entered into a series of agency agreements, including with Tri-Star Investments, of which Jeffrey Tesler is a principal, commencing in 1995 and a series of subcontracts with a Japanese trading company commencing in 1996. We understand that a French magistrate has officially placed Mr. Tesler under investigation for corruption of a foreign public official. In Nigeria, a legislative committee of the National Assembly and the Economic and Financial Crimes Commission, which is organized as part of the executive branch of the government, are also investigating these matters. Our representatives have met with the French magistrate and Nigerian officials. In October 2004, representatives of TSKJ voluntarily testified before the Nigerian legislative committee.

TSKJ suspended the receipt of services from and payments to Tri-Star Investments and the Japanese trading company and has considered instituting legal proceedings to declare all agency agreements with Tri-Star Investments terminated and to recover all amounts previously paid under those agreements. In February 2005, TSKJ notified the Attorney General of Nigeria that TSKJ would not oppose the Attorney General's efforts to have sums of money held on deposit in accounts of Tri-Star Investments in banks in Switzerland transferred to Nigeria and to have the legal ownership of such sums determined in the Nigerian courts.

As a result of these investigations, information has been uncovered suggesting that, commencing at least 10 years ago, members of TSKJ planned payments to Nigerian officials. We have reason to believe that, based on the ongoing investigations, payments may have been made by agents of TSKJ to Nigerian officials. In addition, information uncovered in the summer of 2006 suggests that, prior to 1998, plans may have been made by employees of The M.W. Kellogg Company (a predecessor of a KBR subsidiary) to make payments to government officials in connection with the pursuit of a number of other projects in countries outside of Nigeria. We are reviewing a number of more recently discovered documents related to KBR's activities in countries outside of Nigeria with respect to agents for projects after 1998. Certain activities discussed in this paragraph involve current or former employees or persons who were or are consultants to KBR, and our investigation is continuing.

In June 2004, all relationships with Mr. Stanley and another consultant and former employee of M.W. Kellogg Limited were terminated. The terminations occurred because of Code of Business Conduct violations that allegedly involved the receipt of improper personal benefits from Mr. Tesler in connection with TSKJ's construction of the Bonny Island project.

In 2006 and 2007, KBR suspended the services of other agents in and outside of Nigeria, including one agent who, until such suspension, had worked for KBR outside of Nigeria on several current projects and on numerous older projects going back to the early 1980s. Such suspensions have occurred when possible improper conduct has been discovered or alleged or when Halliburton and KBR have been unable to confirm the agent's compliance with applicable law and the Code of Business Conduct.

If violations of the FCPA were found, a person or entity found in violation could be subject to fines, civil penalties of up to $500,000 per violation, equitable remedies, including disgorgement (if applicable) generally of profits, including prejudgment interest on such profits, causally connected to the violation, and injunctive relief. Criminal penalties could range up to the greater of $2 million per violation or twice the gross pecuniary gain or loss from the violation, which could be substantially greater than $2 million per violation. It is possible that both the SEC and the DOJ could assert that there have been multiple violations, which could lead to multiple fines. The amount of any fines or monetary penalties that could be assessed would depend on, among other factors, the findings regarding the amount, timing, nature, and scope of any improper payments, whether any such payments were authorized by or made with knowledge of us, KBR or our or KBR's affiliates, the amount of gross pecuniary gain or loss involved, and the level of cooperation provided the government authorities during the investigations. Agreed dispositions of these types of violations also frequently result in an acknowledgement of wrongdoing by the entity and the appointment of a monitor on terms negotiated with the SEC and the DOJ to review and monitor current and future business practices, including the retention of agents, with the goal of assuring compliance with the FCPA.

These investigations could also result in third-party claims against us, which may include claims for special, indirect, derivative or consequential damages, damage to our business or reputation, loss of, or adverse effect on, cash flow, assets, goodwill, results of operations, business prospects, profits or business value or claims by directors, officers, employees, affiliates, advisors, attorneys, agents, debt holders, or other interest holders or constituents of us or our current or former subsidiaries. In addition, we could incur costs and expenses for any monitor required by or agreed to with a governmental authority to review our continued compliance with FCPA law.

As of June 30, 2007, we are unable to estimate an amount of probable loss or a range of possible loss related to these matters as it relates to Halliburton directly. However, we provided indemnification in favor of KBR under the master separation agreement for certain contingent liabilities, including Halliburton's indemnification of KBR and any of its greater than 50%-owned subsidiaries as of November 20, 2006, the date of the master separation agreement, for fines or other monetary penalties or direct monetary damages, including disgorgement, as a result of a claim made or assessed by a governmental authority in the United States, the United Kingdom, France, Nigeria, Switzerland, and/or Algeria, or a settlement thereof, related to alleged or actual violations occurring prior to November 20, 2006 of the FCPA or particular, analogous applicable foreign statutes, laws, rules, and regulations in connection with investigations pending as of that date, including with respect to the construction and subsequent expansion by TSKJ of a natural gas liquefaction complex and related facilities at Bonny Island in Rivers State, Nigeria. We recorded the estimated fair market value of this indemnity regarding FCPA matters described above upon our separation from KBR. See Note 2 for additional information.

Our indemnification obligation to KBR does not include losses resulting from third-party claims against KBR, including claims for special, indirect, derivative or consequential damages, nor does our indemnification apply to damage to KBR's business or reputation, loss of, or adverse effect on, cash flow, assets, goodwill, results of operations, business prospects, profits or business value or claims by directors, officers, employees, affiliates, advisors, attorneys, agents, debt holders, or other interest holders or constituents of KBR or KBR's current or former subsidiaries.

In consideration of our agreement to indemnify KBR for the liabilities referred to above, KBR has agreed that we will at all times, in our sole discretion, have and maintain control over the investigation, defense and/or settlement of these FCPA matters until such time, if any, that KBR exercises its right to assume control of the investigation, defense and/or settlement of the FCPA matters as it relates to KBR. KBR has also agreed, at our expense, to assist with Halliburton's full cooperation with any governmental authority in our investigation of these FCPA matters and our investigation, defense and/or settlement of any claim made by a governmental authority or court relating to these FCPA matters, in each case even if KBR assumes control of these FCPA matters as it relates to KBR. If KBR takes control over the investigation, defense and/or settlement of FCPA matters, refuses a settlement of FCPA matters negotiated by us, enters into a settlement of FCPA matters without our consent, or materially breaches its obligation to cooperate with respect to our investigation, defense and/or settlement of FCPA matters, we may terminate the indemnity.

Barracuda-Caratinga arbitration

We also provided indemnification in favor of KBR under the master separation agreement for all out-of pocket cash costs and expenses (except for legal fees and other expenses of the arbitration so long as KBR controls and directs it), or cash settlements or cash arbitration awards in lieu thereof, KBR may incur after November 20, 2006 as a result of the replacement of certain subsea flowline bolts installed in connection with the Barracuda-Caratinga project. Under the master separation agreement, KBR currently controls the defense, counterclaim, and settlement of the subsea flowline bolts matter. As a condition of our indemnity, for any settlement to be binding upon us, KBR must secure our prior written consent to such settlement's terms. We have the right to terminate the indemnity in the event KBR enters into any settlement without our prior written consent. See Note 2 for additional information regarding the KBR indemnification.

At Petrobras' direction, KBR replaced certain bolts located on the subsea flowlines that failed through mid-November 2005, and KBR has informed us that additional bolts have failed thereafter, which were replaced by Petrobras. These failed bolts were identified by Petrobras when it conducted inspections of the bolts. The designation of the material to be used for the bolts was issued by Petrobras, and as such, we understand that KBR believes the cost resulting from any replacement is not KBR's responsibility. We understand Petrobras disagrees. We understand KBR believes several possible solutions may exist, including replacement of the bolts. Estimates indicate that costs of these various solutions range up to $140 million. In March 2006, Petrobras commenced arbitration against KBR claiming $220 million plus interest for the cost of monitoring and replacing the defective bolts and all related costs and expenses of the arbitration, including the cost of attorneys fees. We understand KBR intends to vigorously defend and pursue recovery of the costs incurred to date through the arbitration process and to that end has submitted a counterclaim in the arbitration seeking the recovery of $22 million. The final arbitration hearing is not expected to begin until 2008.

Securities and related litigation

In June 2002, a class action lawsuit was filed against us in federal court alleging violations of the federal securities laws after the SEC initiated an investigation in connection with our change in accounting for revenue on long-term construction projects and related disclosures. In the weeks that followed, approximately twenty similar class actions were filed against us. Several of those lawsuits also named as defendants several of our present or former officers and directors. The class action cases were later consolidated, and the amended consolidated class action complaint, styled *Richard Moore, et al. v. Halliburton Company, et al.,* was filed and served upon us in April 2003 (the "*Moore* class action"). As a result of a substitution of lead plaintiffs, the case is now styled *Archdiocese of Milwaukee Supporting Fund ("AMSF") v. Halliburton Company, et al.* We settled with the SEC in the second quarter of 2004.

In early May 2003, we entered into a written memorandum of understanding setting forth the terms upon which the *Moore* class action would be settled. In June 2003, the lead plaintiffs in the *Moore* class action filed a motion for leave to file a second amended consolidated complaint, which was granted by the court. In addition to restating the original accounting and disclosure claims, the second amended consolidated complaint included claims arising out of the 1998 acquisition of Dresser Industries, Inc. by Halliburton, including that we failed to timely disclose the resulting asbestos liability exposure (the "Dresser claims"). The memorandum of understanding contemplated settlement of the Dresser claims as well as the original claims.

In June 2004, the court entered an order preliminarily approving the settlement. Following the transfer of the case to another district judge, the court held that evidence of the settlement's fairness was inadequate, denied the motion for final approval of the settlement, and ordered the parties to mediate. The mediation was unsuccessful.

In April 2005, the court appointed new co-lead counsel and named AMSF the new lead plaintiff, directing that they file a third consolidated amended complaint and that we file our motion to dismiss. The court held oral arguments on that motion in August 2005, at which time the court took the motion under advisement. In March 2006, the court entered an order in which it granted the motion to dismiss with respect to claims arising prior to June 1999 and granted the motion with respect to certain other claims while permitting the plaintiffs to replead those claims to correct deficiencies in their earlier complaint. In April 2006, the plaintiffs filed their fourth amended consolidated complaint. We filed a motion to dismiss those portions of the complaint that had been repled. A hearing was held on that motion in July 2006, and in March 2007 the court ordered dismissal of the claims against all individual defendants other than our CEO. The court ordered that the case proceed against our CEO and Halliburton. In response to a motion by the lead plaintiff, on February 26, 2007 the court ordered the removal and replacement of their co-lead counsel. As of June 30, 2007, we had not accrued any amounts related to this matter.

Operations in Iran

We received and responded to an inquiry in mid-2001 from the Office of Foreign Assets Control (OFAC) of the United States Treasury Department with respect to operations in Iran by a Halliburton subsidiary incorporated in the Cayman Islands. The OFAC inquiry requested information with respect to compliance with the Iranian Transaction Regulations. These regulations prohibit United States citizens, including United States corporations and other United States business organizations, from engaging in commercial, financial, or trade transactions with Iran, unless authorized by OFAC or exempted by statute. Our 2001 written response to OFAC stated that we believed that we were in compliance with applicable sanction regulations. In the first quarter of 2004, we responded to a follow-up letter from OFAC requesting additional information. We understand this matter has now been referred by OFAC to the DOJ. In July 2004, we received a grand jury subpoena from an Assistant United States District Attorney requesting the production of documents. We are cooperating with the government's investigation and responded to the subpoena by producing documents in September 2004. As of June 30, 2007, we had not accrued any amounts related to this investigation.

Separate from the OFAC inquiry, we completed a study in 2003 of our activities in Iran during 2002 and 2003 and concluded that these activities were in compliance with applicable sanction regulations. These sanction regulations require isolation of entities that conduct activities in Iran from contact with United States citizens or managers of United States companies. Notwithstanding our conclusions that our activities in Iran were not in violation of United States laws and regulations, we announced in April 2007 that all of our contractual commitments in Iran have been completed, and we are no longer working in Iran.

David Hudak and International Hydrocut Technologies Corp.

In October 2004, David Hudak and International Hydrocut Technologies Corp. (collectively, Hudak) filed suit against us in the United States District Court alleging civil Racketeer Influenced and Corporate Organizations Act violations, fraud, breach of contract, unfair trade practices, and other torts. The action, which seeks unspecified damages, arises out of Hudak's alleged purchase from us in early 1994 of certain explosive charges that were later alleged by the DOJ to be military ordnance, the possession of which by persons not possessing the requisite licenses and registrations is unlawful. As a result of that allegation by the government, Hudak was charged with, but later acquitted of, certain criminal offenses in connection with his possession of the explosive charges. As mentioned above, the alleged transaction(s) took place more than 10 years ago. The fact that most of the individuals that may have been involved, as well as the entities themselves, are no longer affiliated with us will complicate our investigation. For those reasons and because the litigation is in its preliminary stages, it is premature to assess the likelihood of an adverse result. It is our intention to vigorously defend this action. Amounts accrued related to this matter as of June 30, 2007 were not material.

M-I, LLC antitrust litigation

On February 16, 2007, we were informed that M-I, LLC, a competitor of ours in the drilling fluids market has sued us for allegedly attempting to monopolize the market for invert emulsion drilling fluids used in deep water and/or in cold water temperatures. The claims M-I asserts are based upon its allegation that the patent issued for our Accolade® drilling fluid was invalid as a result of its allegedly having been procured by fraud on the United States Patent and Trademark Office and that our subsequent prosecution of an infringement action against M-I amounted to predatory conduct in violation of Section 2 of the Sherman Antitrust Act. In October 2006, a federal court dismissed our infringement action based upon its holding that the claims in our patent were indefinite and the patent was, therefore, invalid. That judgment is now on appeal. M-I also alleges that we falsely advertised our Accolade® drilling fluid in violation of the Lanham Act and California law and that our earlier infringement action amounted to malicious prosecution in violation of Texas state law. M-I seeks compensatory damages, which it claims should be trebled, as well as punitive damages and injunctive relief. We believe that M-I's claims are without merit and intend to aggressively defend them. As of June 30, 2007, we had not accrued any amounts in connection with this matter.

Environmental

We are subject to numerous environmental, legal, and regulatory requirements related to our operations worldwide. In the United States, these laws and regulations include, among others:

- the Comprehensive Environmental Response, Compensation, and Liability Act;
- the Resources Conservation and Recovery Act;
- the Clean Air Act;
- the Federal Water Pollution Control Act; and
- the Toxic Substances Control Act.

In addition to the federal laws and regulations, states and other countries where we do business often have numerous environmental, legal, and regulatory requirements by which we must abide. We evaluate and address the environmental impact of our operations by assessing and remediating contaminated properties in order to avoid future liabilities and comply with environmental, legal, and regulatory requirements. On occasion, we are involved in specific environmental litigation and claims, including the remediation of properties we own or have operated, as well as efforts to meet or correct compliance-related matters. Our Health, Safety and Environment group has several programs in place to maintain environmental leadership and to prevent the occurrence of environmental contamination.

We do not expect costs related to these remediation requirements to have a material adverse effect on our consolidated financial position or our results of operations. Our accrued liabilities for environmental matters were $47 million as of June 30, 2007 and $39 million as of December 31, 2006. The liability covers numerous properties, and no individual property accounts for more than $10 million of the liability balance. We have subsidiaries that have been named as potentially responsible parties along with other third parties for 10 federal and state superfund sites for which we have established a liability. As of June 30, 2007, those 10 sites accounted for approximately $11 million of our total $47 million liability. For any particular federal or state superfund site, since our estimated liability is typically within a range and our accrued liability may be the amount on the low end of that range, our actual liability could eventually be well in excess of the amount accrued. In some instances, we have been named a potentially responsible party by a regulatory agency, but, in each of those cases, we do not believe we have any material liability. We also could be subject to third-party claims with respect to environmental matters for which we have been named as a potentially responsible party.

Letters of credit

In the normal course of business, we have agreements with banks under which approximately $2.2 billion of letters of credit, surety bonds, or bank guarantees were outstanding as of June 30, 2007, including $1.3 billion that relate to KBR. These KBR letters of credit, surety bonds, or bank guarantees are being guaranteed by us in favor of KBR's customers and lenders. KBR has agreed to compensate us for these guarantees and indemnify us if we are required to perform under any of these guarantees. Some of the outstanding letters of credit have triggering events that would entitle a bank to require cash collateralization.

Note 11. Income per Share

Basic income per share is based on the weighted average number of common shares outstanding during the period. Diluted income per share includes additional common shares that would have been outstanding if potential common shares with a dilutive effect had been issued. A reconciliation of the number of shares used for the basic and diluted income per share calculations is as follows:

	Three Months Ended June 30		Six Months Ended June 30	
Millions of shares	2007	2006	2007	2006
Basic weighted average common shares outstanding	905	1,026	949	1,025
Dilutive effect of:				
Convertible senior notes premium	29	32	26	31
Stock options	6	9	6	10
Restricted stock	2	3	2	3
Diluted weighted average common shares outstanding	942	1,070	983	1,069

Excluded from the computation of diluted income per share are options to purchase four million and three million shares of common stock that were outstanding during the three and six months ended June 30, 2007 and one million shares during the three and six months ended June 30, 2006. These options were outstanding during these quarters but were excluded because they were antidilutive, as the option exercise price was greater than the average market price of the common shares.

Effective April 5, 2007, common shares outstanding were reduced by the 85.3 million shares of our common stock that we accepted in exchange for the shares of KBR, Inc. common stock we owned.

Note 12. Income Taxes

Effective January 1, 2007, we adopted Financial Accounting Standards Board (FASB) Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109." FIN 48, as amended May 2007 by FASB Staff Position FIN 48-1, "Definition of 'Settlement' in FASB Interpretation No. 48," prescribes a minimum recognition threshold and measurement methodology that a tax position taken or expected to be taken in a

tax return is required to meet before being recognized in the financial statements. It also provides guidance for derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition.

As a result of the adoption of FIN 48, we recognized a decrease of $4 million in other liabilities to account for a decrease in unrecognized tax benefits and an increase of $34 million for accrued interest and penalties, which were accounted for as a net reduction of $30 million to the January 1, 2007 balance of retained earnings. Of the $30 million reduction to retained earnings, $10 million was attributable to KBR, which is now reported as discontinued operations in the condensed consolidated financial statements.
The following presents a rollforward of our unrecognized tax benefits and associated interest and penalties.

Millions of dollars	Unrecognized Tax Benefits	Interest and Penalties
Balance at January 1, 2007	$ 266	$ 47
Increase (decrease) in prior year tax positions	(8)	1
Reclassification to discontinued operations	(24)	(13)
Balance at June 30, 2007	$ 234	$ 35

We recognize interest and penalties related to unrecognized tax benefits within the provision for income taxes on continuing operations in our condensed consolidated statements of operations.
At March 31, 2007, approximately $30 million of tax benefits associated with United States federal research and development credits was included in the balance of unrecognized tax benefits that could have been resolved with the United States Internal Revenue Service (IRS) within the next twelve months. As of June 30, 2007, based upon ongoing discussions with the IRS, we now believe that this issue will not be resolved within the next twelve months. If this particular tax return position is not resolved in our favor, there would be no obligation to make additional payments to the IRS because we had not previously claimed these benefits and, therefore, we had not previously reduced taxes paid or payable for these credits. Also, as of June 30, 2007, a significant portion of our non-United States unrecognized tax benefits, while not individually significant, could be settled within the next twelve months. As of June 30, 2007, we estimated that the entire balance of unrecognized tax benefits, if resolved in our favor, would positively impact the effective tax rate and, therefore, be recognized as additional tax benefits in our income statement.
We file income tax returns in the United States federal jurisdiction and in various states and foreign jurisdictions. In most cases, we are no longer subject to United States federal, state, and local, or non-United States income tax examination by tax authorities for years before 1998.

Note 13. Retirement Plans
The components of net periodic benefit cost related to pension benefits for the three and six months ended June 30, 2007 and June 30, 2006 were as follows:

	Three Months Ended June 30			
	2007		2006	
Millions of dollars	United States	International	United States	International
Components of net periodic benefit cost:				
Service cost	$ -	$ 6	$ -	$ 6
Interest cost	1	10	1	8
Expected return on plan assets	(1)	(9)	(1)	(7)
Recognized actuarial loss (gain)	2	2	1	2
Net periodic benefit cost	$ 2	$ 9	$ 1	$ 9

	Six Months Ended June 30			
	2007		2006	
Millions of dollars	United States	International	United States	International
Components of net periodic benefit cost:				
Service cost	$ -	$ 12	$ -	$ 11
Interest cost				