

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2002

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-13926

DIAMOND OFFSHORE DRILLING, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation  
or organization)

76-0321760

(I.R.S. Employer  
Identification No.)

15415 Katy Freeway  
Houston, Texas  
77094

(Address of principal executive offices)

(Zip Code)

(281) 492-5300

(Registrant's telephone number, including area code)

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

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

As of August 12, 2002	Common stock, \$0.01 par value per share	131,483,155 shares
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DIAMOND OFFSHORE DRILLING, INC.

TABLE OF CONTENTS FOR FORM 10-Q

QUARTER ENDED JUNE 30, 2002

	PAGE NO.	COVER
PAGE.....	1	TABLE
OF CONTENTS.....	2	PART
I. FINANCIAL INFORMATION.....	3	ITEM
1. FINANCIAL STATEMENTS Consolidated Balance		
Sheets.....	3	Consolidated Statements of
Income.....	4	Consolidated Statements of Cash
Flows.....	5	Notes to Unaudited Consolidated Financial
Statements.....	6	ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS.....	16	ITEM 3.
QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK .....	28	PART II. OTHER
INFORMATION.....	29	ITEM 1. LEGAL
PROCEEDINGS.....	29	ITEM 2. CHANGES IN
SECURITIES AND USE OF PROCEEDS.....	29	ITEM 3. DEFAULTS UPON
SENIOR SECURITIES.....	29	ITEM 4. SUBMISSION OF MATTERS
TO A VOTE OF SECURITY HOLDERS.....	29	ITEM 5. OTHER
INFORMATION.....	30	ITEM 6. EXHIBITS AND
REPORTS ON FORM 8-K.....	30	
SIGNATURES.....	31	
		EXHIBIT
INDEX.....	32	

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

DIAMOND OFFSHORE DRILLING, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS  
(In thousands, except share data)

JUNE 30, DECEMBER 31, -----	2002	2001	-----
----- (UNAUDITED) ASSETS			
Cash and cash equivalents			
..... \$ 448,739			
398,990 Marketable securities			
..... 762,909			
748,387 Accounts receivable			
..... 170,208			
193,653 Rig inventory and supplies			
..... 40,754			
Prepaid expenses and other			
..... 33,002			
----- Total current assets			
..... 1,455,612			
1,427,415 DRILLING AND			
OTHER PROPERTY AND EQUIPMENT, NET OF ACCUMULATED DEPRECIATION			
..... 2,032,131			
2,002,873 GOODWILL, NET OF ACCUMULATED AMORTIZATION			
..... 31,522			
38,329 OTHER ASSETS			
.....			
32,694 33,900 -----			
Total assets			
..... \$ 3,551,959			
\$ 3,502,517			
===== LIABILITIES AND STOCKHOLDERS' EQUITY			
CURRENT LIABILITIES: Current portion of long-term debt			
..... \$ 10,426			
\$ 10,426			
Accounts payable			
.....			
40,491 31,924 Accrued liabilities			
..... 87,781			
87,742 Taxes payable			
.....			
5,111 5,862 Securities sold under repurchase agreements			
..... 252,188			
199,062 -----			
Total current liabilities			
..... 395,997			
335,016 LONG-TERM DEBT			
.....			
928,068 920,636 DEFERRED TAX LIABILITY			
..... 379,815			
376,095 OTHER LIABILITIES			
.....			
14,361 17,624 -----			
Total liabilities			
..... 1,718,241			
1,649,371 -----			
--- COMMITMENTS AND CONTINGENCIES			
STOCKHOLDERS' EQUITY: Preferred stock (par value \$0.01, 25,000,000 shares			
authorized, none issued and			
outstanding).....			
-- Common stock (par value \$0.01, 500,000,000 shares			
authorized, 133,457,055 shares issued and 131,553,155 shares			
outstanding at June 30, 2002 and 133,457,055 shares issued and			
132,053,155 shares outstanding at December 31, 2001)			
..... 1,335			
1,335 Additional paid-			
in capital			
..... 1,263,692			
1,267,952 Retained earnings			
.....			
626,076 624,507 Accumulated other comprehensive loss			
..... (2,685)			
(2,880) Treasury			
stock, at net cost (1,903,900 shares at June 30, 2002 and			
1,403,900 shares at December 31,			
2001)..... (54,700)			
(37,768) -----			
Total stockholders' equity			
..... 1,833,718			
1,853,146 -----			
--- Total liabilities and stockholders' equity ....			
\$ 3,551,959			
\$ 3,502,517 =====			

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE CONSOLIDATED  
FINANCIAL STATEMENTS.



DIAMOND OFFSHORE DRILLING, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME  
(Unaudited)  
(In thousands, except per share data)

	THREE MONTHS ENDED		SIX MONTHS ENDED		JUNE 30,	
	JUNE 30,		JUNE 30,		JUNE 30,	
	2002	2001	2002	2001	2002	2001
REVENUES						
\$ 179,674	\$ 227,331	\$ 373,342	\$ 432,556			
OPERATING EXPENSES: Contract drilling						
119,592						
114,556	239,916	223,253	Depreciation and			
amortization			44,585	42,171		
87,282	83,730	General and administrative				
7,440	6,079	14,088				
12,966						
Total operating expenses						
171,617	162,806	341,286				
319,949						
OPERATING INCOME						
8,057						
64,525	32,056	112,607	OTHER INCOME (EXPENSE):			
Interest income						
7,651	11,593					
17,232	23,280	Interest expense				
(6,290)						
(17,999)	(11,760)	(26,317)	Gain on sale of			
marketable securities			8,671	6,795		
12,163	12,906	Other, net				
482	220					
1,382	(2,665)					
INCOME BEFORE INCOME TAX						
EXPENSE						
18,571	65,134					
51,073	119,811	INCOME TAX EXPENSE				
(6,609)						
(21,374)	(16,553)	(39,223)				
NET INCOME						
\$ 11,962	\$ 43,760	\$ 34,520	\$ 80,588			
EARNINGS PER SHARE: BASIC						
\$						
0.09	\$ 0.33	\$ 0.26	\$ 0.60			
DILUTED						
\$						
0.09	\$ 0.32	\$ 0.26	\$ 0.59			
WEIGHTED						
AVERAGE SHARES OUTSTANDING: Shares of common						
stock						
131,553						
133,447	131,669	133,307	Dilutive potential			
shares of common stock			8	8,895	9,426	
9,372						
Total weighted average shares						
outstanding						
131,561	142,342	141,095	142,679			

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE CONSOLIDATED  
FINANCIAL STATEMENTS.

DIAMOND OFFSHORE DRILLING, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)  
(In thousands)

SIX MONTHS ENDED JUNE 30, -----		
2002 2001 -----		
	OPERATING ACTIVITIES:	
	Net income	
\$ 34,520	\$ 80,588	Adjustments to reconcile net income to
		net cash provided by operating activities: Depreciation
		and amortization .....
	87,282	83,730 Gain on sale of assets
		..... (65) (209)
		Gain on sale of marketable securities
		..... (12,163) (12,906) Loss from
		early debt extinguishment .....
	-- 11,880	Deferred tax provision
		..... 10,414
	28,656	Accretion of discounts on marketable securities
		..... (2,028) (2,312) Amortization of debt
		issuance costs .....
		655 783
		Amortization of discount on zero coupon convertible
		debentures .... 7,432 7,176 Changes in operating assets
		and liabilities: Accounts receivable
		..... 23,445
	(58,092)	Rig inventory and supplies and other current
		assets ..... 12,629 (11,841) Other assets, non-
		current .....
		551
	(4,781)	Accounts payable and accrued liabilities
		..... 8,606 8,655 Taxes payable
		.....
	(751)	8,205 Other liabilities, non-current
		..... (3,263) (610) Other
		items, net
		.....
(1,673)	(83)	----- Net cash provided
		by operating activities ..... 165,591
138,839		----- INVESTING ACTIVITIES:
	Capital expenditures	
		.....
	(117,823)	(96,377) Proceeds from sale of assets
		..... 1,348 1,118 Net
		change in marketable securities
		..... 739 (54,516) Securities
		sold under repurchase agreements, net
		..... 53,126 -- Settlement of forward
		contracts .....
		912 -- --
		----- Net cash used in investing
		activities ..... (61,698) (149,775) -
		----- FINANCING ACTIVITIES:
	Acquisition of treasury stock	
		..... (20,000) --
	Settlement of put options	
		..... (1,193) --
	Proceeds from sale of put options	
		..... -- 3,068 Payment of
		dividends
		..... (32,951)
(33,326)	Early extinguishment of debt - 3.75% convertible	
	subordinated notes . -- (395,622) Issuance of 1.5%	
	convertible senior debentures .....	--
	460,000 Debt issuance costs-1.5% convertible senior	
	debentures .....	-- (10,602) -----
	----- Net cash provided by (used in) financing	
	activities ..... (54,144) 23,518 -----	
	----- NET CHANGE IN CASH AND CASH EQUIVALENTS	
		..... 49,749 12,582 Cash
		and cash equivalents, beginning of period
		..... 398,990 144,456 -----
	----- Cash and cash equivalents, end of period	
		..... \$ 448,739 \$ 157,038
		=====

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE CONSOLIDATED



DIAMOND OFFSHORE DRILLING, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. GENERAL

The consolidated financial statements of Diamond Offshore Drilling, Inc. and subsidiaries (the "Company") should be read in conjunction with the Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 1-13926).

Interim Financial Information

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all disclosures required by generally accepted accounting principles for complete financial statements. The consolidated financial information has not been audited but, in the opinion of management, includes all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation of the consolidated balance sheets, statements of income, and statements of cash flows at the dates and for the periods indicated. Results of operations for interim periods are not necessarily indicative of results of operations for the respective full years.

Cash and Cash Equivalents and Marketable Securities

Short-term, highly liquid investments that have an original maturity of three months or less and deposits in money market mutual funds that are readily convertible into cash are considered cash equivalents. Cash equivalents at June 30, 2002 and December 31, 2001 included \$252.2 million and \$199.1 million, respectively, of collateral received in connection with securities sold under repurchase agreements. See "Securities Sold Under Agreements to Repurchase."

The Company's investments are classified as available for sale and stated at fair value. Accordingly, any unrealized gains and losses, net of taxes, are reported in the Consolidated Balance Sheets in "Accumulated other comprehensive income" until realized. The cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity and such adjustments are included in the Consolidated Statements of Income in "Interest income." The sale and purchase of securities are recorded on the date of the trade. The cost of debt securities sold is based on the specific identification method and the cost of equity securities sold is based on the average cost method. Realized gains or losses and declines in value, if any, judged to be other than temporary are reported in the Consolidated Statements of Income in "Other income (expense)."

Securities Sold Under Agreements to Repurchase

The Company accounts for repurchase agreements in accordance with Statement of Financial Accounting Standards ("SFAS") No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." From time to time the Company may lend securities to unrelated parties, primarily major brokerage firms. Borrowers of these securities must deposit collateral with the Company equal to 100% of the fair value of these securities, if the collateral is cash, or 102% of the fair value of the securities, if the collateral is securities. Cash deposits from these transactions are invested in short-term investments and are included in the Consolidated Balance Sheets in "Cash and cash equivalents." A liability of \$252.2 million at June 30, 2002 and \$199.1 million at December 31, 2001 was recognized for the obligation to return the collateral. The Company continues to receive interest income on the loaned debt securities, as beneficial owner, and accordingly, the loaned debt securities are included in the Consolidated Balance Sheets in "Marketable securities." The fair value of collateral held and included with "Marketable securities" at June 30, 2002 and December 31, 2001 was \$252.9 million and \$198.7 million, respectively. Interest expense associated with the related liability is recorded as an offset to "Interest income" in the Consolidated Statements of Income.

Derivative Financial Instruments

The Company accounts for derivative financial instruments in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" and its corresponding amendments under SFAS No. 138.

Derivative financial instruments of the Company include forward exchange contracts and a contingent interest provision that is embedded in the 1.5% convertible senior debentures due 2031 (the "1.5% Debentures") issued on April 11, 2001. See Note 4.

#### Supplementary Cash Flow Information

Cash payments made for interest on long-term debt, including commitment fees, totaled \$3.4 million for the six months ended June 30, 2002 and \$7.5 million for the six months ended June 30, 2001. Cash payments for foreign income taxes, net of foreign tax refunds, were \$6.6 million during the six months ended June 30, 2002. A \$14.5 million net cash refund of U.S. income tax was received during the six months ended June 30, 2002. Cash payments for income taxes, net of foreign tax refunds, made during the six months ended June 30, 2001 totaled \$2.2 million.

#### Capitalized Interest

Interest cost for construction and upgrade of qualifying assets is capitalized. A reconciliation of the Company's total interest cost to "Interest expense" as reported in the Consolidated Statements of Income is as follows:

THREE MONTHS ENDED SIX MONTHS ENDED	
-----	
-----	
-----	
-----	
-----	
JUNE 30, 2002	
JUNE 30, 2001	
JUNE 30, 2002	
JUNE 30, 2001	
-----	
- - - - -	
- - - - -	
-----	
----- (IN	
THOUSANDS)	
Total	
interest cost	
including	
amortization	
of debt	
issuance	
costs \$ 6,602	
\$ 6,644 \$	
13,186 \$	
15,399	
Capitalized	
interest	
(312) (525)	
(1,426) (962)	
Debt	
redemption --	
11,880 --	
11,880 -----	
-----	
-----	
-----	
- Total	
interest	
expense \$	
6,290 \$	
17,999 \$	
11,760 \$	
26,317	

=====

=====

=====

=====

Goodwill

Prior to January 1, 2002, goodwill from the merger with Arethusa (Off-Shore) Limited ("Arethusa") had been amortized on a straight-line basis over 20 years. The Company adopted SFAS No. 142, "Goodwill and Other Intangible Assets" on January 1, 2002 and, accordingly, has suspended amortization of goodwill. Goodwill and accumulated amortization on January 1, 2002 was \$69.0 million and \$30.7 million, respectively. Amortization charged to operating expense during the quarter and six months ended June 30, 2001 totaled \$0.8 million and \$1.7 million, respectively. Goodwill is reduced for adjustments representing tax benefits not previously recognized for the excess of tax deductible goodwill over book goodwill. See Note 6.

#### Debt Issuance Costs

Debt issuance costs are included in the Consolidated Balance Sheets in "Other assets" and are amortized over the terms of the related debt.

#### Treasury Stock and Common Equity Put Options

Depending on market conditions, the Company may, from time to time, purchase shares of its common stock or issue put options in the open market or otherwise. The purchase of treasury stock is accounted for using the cost method which reports the cost of the shares acquired in "Treasury stock" as a deduction from stockholders' equity in the Consolidated Balance Sheets.

During the six months ended June 30, 2002 the Company purchased 500,000 shares of its common stock at an aggregate cost of \$20.0 million, or \$40.00 per share, upon the exercise of put options sold in February 2001. The Company reduced "Additional paid-in-capital" in the Consolidated Balance Sheet by \$3.1 million, the amount of the premium received for the sale of these put options, and reported the net cost of the shares, \$16.9 million, in "Treasury stock." During the six months ended June 30, 2001, the Company purchased 100,000 shares of its common stock, which settled on July 3, 2001, at an aggregate cost of \$3.3 million, or at an average cost of \$33.00 per share. In August 2002 the Company purchased 70,000 shares of its common stock at an aggregate cost of \$1.4 million, or at an average cost of \$20.59 per share.

The Company settled put options which covered 1,000,000 shares of its common stock during the first six months of 2002 with cash payments totaling \$1.2 million and reduced "Additional paid-in-capital" in the Consolidated Balance Sheet for amounts paid to settle these put options. The Company's remaining put options sold in 2001, which covered 187,321 shares of the Company's common stock, expired during the first half of 2002.

#### Comprehensive Income

Comprehensive income is the change in equity of a business enterprise during a period from transactions and other events and circumstances except those transactions resulting from investments by owners and distributions to owners. For the quarter and six months ended June 30, 2002, comprehensive income totaled \$18.8 million and \$34.7 million, respectively. For the quarter and six months ended June 30, 2001, comprehensive income totaled \$39.7 million and \$81.4 million, respectively. Comprehensive income includes net income, foreign currency translation gains and losses, minimum pension liability adjustments and unrealized holding gains and losses on marketable securities.

#### Currency Translation

The Company's primary functional currency is the U.S. dollar. Certain of the Company's subsidiaries use the local currency in the country where they conduct operations as their functional currency. These subsidiaries translate assets and liabilities at period-end exchange rates while income and expense accounts are translated at average exchange rates. Translation adjustments are reflected in the Consolidated Balance Sheets in "Accumulated other comprehensive gains/ (losses)." Currency transaction gains and losses are included in the Consolidated Statements of Income in "Other income (expense)." Additionally, translation gains and losses of subsidiaries operating in hyperinflationary economies are included in operating results.

#### Revenue Recognition

Income from dayrate drilling contracts is recognized currently. In connection with such drilling contracts, the Company may receive lump-sum fees for the mobilization of equipment and personnel. The excess of mobilization fees received over costs incurred to mobilize an offshore rig from one market to another is recognized over the term of the related drilling contract. Absent a contract, mobilization costs are recognized currently. Lump-sum payments received from customers relating to specific contracts are deferred and amortized to income over the term of the drilling contract.

Income from offshore turnkey drilling contracts is recognized on the completed contract method, with revenues accrued to the extent of costs until the specified turnkey depth and other contract requirements are met. Provisions for future losses on turnkey drilling contracts are recognized when it becomes apparent that expenses to be incurred on a specific contract will exceed the revenue from that contract.

#### Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 amount of revenues and expenses during the reporting period. Actual results could differ from those estimated.

#### Reclassifications

Certain amounts applicable to prior periods have been reclassified to conform to the classifications currently followed. Such reclassifications do not affect earnings.

## Recent Accounting Pronouncements

In July 2002 the Financial Accounting Standards Board ("FASB") issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. SFAS No. 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. The Company does not expect the adoption of SFAS No. 146 to have a material impact on the Company's consolidated results of operations, financial position or cash flows.

In April 2002 the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment to FASB Statement No. 13, and Technical Corrections." The rescission of SFAS No. 4 and 64 by SFAS No. 145 streamlines the reporting of debt extinguishments and requires that only gains and losses from extinguishments meeting the criteria in Opinion 30 would be classified as extraordinary. Thus, gains or losses arising from extinguishments that are part of a company's recurring operations would not be reported as an extraordinary item. SFAS No. 145 is effective for fiscal years beginning after May 15, 2002 with earlier adoption encouraged. The Company adopted SFAS No. 145 in April 2002 and, accordingly, reclassified its April 2001 extraordinary loss of \$7.7 million, from early extinguishment of debt, as a result of the Company's redemption of its outstanding 3.75% Convertible Subordinated Notes due 2007. The pre-tax loss from early extinguishment of debt of \$11.9 million was reclassified to "Interest expense." The related tax benefit was reclassified to "Income tax expense."

In October 2001 the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 replaces SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" and provides updated guidance concerning the recognition and measurement of an impairment loss for certain types of long-lived assets. SFAS No. 144 is effective for fiscal years beginning after December 15, 2001 with earlier application encouraged. The Company's adoption of SFAS No. 144 in January 2002 has not had, nor is it expected to have, a material impact on the Company's consolidated results of operations, financial position or cash flow.

In August 2001 the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 addresses financial accounting and reporting obligations associated with the retirement of tangible, long-lived assets and their associated asset retirement costs. SFAS No. 143 is effective for fiscal years beginning after June 15, 2002 with early adoption encouraged. Adoption of SFAS No. 143 in 2003 is not expected to have a material impact on the Company's consolidated results of operations, financial position or cash flows.

In June 2001 the FASB issued two new pronouncements, SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires that all business combinations be accounted for by the purchase method and applies to all business combinations initiated after June 30, 2001 and also applies to all business combinations accounted for using the purchase method for which the date of acquisition is July 1, 2001 or later. There are also transition provisions that apply to business combinations completed before July 1, 2001, that were accounted for by the purchase method. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001 for all goodwill and other intangible assets recognized in an entity's statement of financial position at that date, regardless of when those assets were initially recognized. The Company adopted SFAS No. 142 on January 1, 2002 and has suspended amortization of goodwill. The adoption of SFAS No. 142 has not had, nor is it expected to have, a material impact on the Company's consolidated results of operations, financial position or cash flows. See Note 6.

## 2. EARNINGS PER SHARE

A reconciliation of the numerators and the denominators of the basic and diluted per-share computations follows:

	THREE MONTHS ENDED JUNE 30,	SIX MONTHS ENDED JUNE 30,	2002	2001	2002
	2001	2001	2002	2001	2002
(IN THOUSANDS, EXCEPT PER SHARE DATA) NET INCOME - BASIC (NUMERATOR):					
.....	\$ 11,962	\$ 43,760	\$ 34,520	\$ 80,588	Effect of dilutive potential shares Convertible subordinated notes - 3.75% .....
.....	-- 130	-- 2,502	Convertible senior debentures - 1.5% .....	-- 956	2,083 972
NET INCOME INCLUDING CONVERSIONS					
- DILUTED (NUMERATOR) ...	\$ 11,962	\$ 44,846	\$ 36,603	\$ 84,062	=====
WEIGHTED AVERAGE SHARES - BASIC (DENOMINATOR): .....					
.....	131,553	133,447	131,669	133,307	Effect of dilutive potential shares Convertible subordinated notes - 3.75% .....
.....	-- 532	-- 5,172	Convertible senior debentures - 1.5% .....	-- 8,352	9,383 4,199 Stock options .....
.....	8	-- 6	Put options .....	-- 11	37 1
WEIGHTED AVERAGE SHARES INCLUDING CONVERSIONS - DILUTED (DENOMINATOR)					
.....	131,561	142,342	141,095	142,679	=====
EARNINGS PER SHARE: Basic					
.....	\$ 0.09	\$ 0.33	\$ 0.26	\$ 0.60	=====
Diluted					
.....	\$ 0.09	\$ 0.32	\$ 0.26	\$ 0.59	=====

The computation of diluted earnings per share ("EPS") for the quarter ended June 30, 2002 excludes approximately 9.4 million potentially dilutive shares issuable upon conversion of the Company's 1.5% Debentures, issued in April 2001. Diluted EPS for the quarter and six months ended June 30, 2002 and 2001 also excludes approximately 6.9 million potentially dilutive shares issuable upon conversion of the Company's zero coupon convertible debentures due 2020 ("Zero Coupon Debentures"), issued in June 2000. The inclusion of such shares would be antidilutive.

Put options covering 1,687,321 shares of common stock at various stated exercise prices per share were outstanding during part of the first half of 2002 prior to their expiration or settlement. The computation of diluted EPS for the quarter and six months ended June 30, 2002 excluded put options covering 1,687,321 shares and 1,187,321 shares of common stock, respectively, because the options' exercise prices were less than the average market price of the common stock.

The incremental shares calculated from non-qualified stock options that were included in the computation of diluted EPS for the quarter and six months ended June 30, 2002 did not include stock options representing 182,700 shares of common stock. The incremental shares calculated from non-qualified stock options included in the computation of diluted EPS for the quarter and six months ended June 30, 2001 were immaterial for presentation purposes and did not include stock options representing 112,000 shares of common stock. Certain stock options were excluded because the options' exercise prices were more than the average market price per share of the common stock.

### 3. MARKETABLE SECURITIES

Investments classified as available for sale are summarized as follows:

JUNE 30, 2002 -----  
 -----  
 UNREALIZED FAIR COST GAIN VALUE --  
 -----  
 ----- (IN THOUSANDS) Debt  
 securities issued by the U.S.  
 Treasury and other U.S. government  
 agencies: Due within one year  
 ..... \$ 324,001 \$  
 -- \$ 324,001 Due after one year  
 through five years ... 298,680  
 4,800 303,480 Collateralized  
 mortgage obligations .....  
 135,059 369 135,428 -----  
 ----- Total  
 .....  
 \$ 757,740 \$ 5,169 \$ 762,909  
 =====  
 =====

DECEMBER 31, 2001 -----  
 -----  
 UNREALIZED FAIR COST GAIN VALUE --  
 -----  
 (IN THOUSANDS) Debt securities  
 issued by the U.S. Treasury and  
 other U.S. government agencies:  
 Due after one year through five  
 years ... \$ 247,453 \$ 2,689 \$  
 250,142 Due after five years  
 through ten years .. 54,355 1,095  
 55,450 Collateralized mortgage  
 obligations ..... 442,518 277  
 442,795 -----  
 ----- Total  
 .....  
 \$ 744,326 \$ 4,061 \$ 748,387  
 =====  
 =====

All of the Company's investments are included as current assets in the Consolidated Balance Sheets in "Marketable securities," representing the investment of cash available for current operations.

Proceeds from sales of marketable securities and gross realized gains and losses are summarized as follows:

THREE MONTHS ENDED JUNE 30, -----  
 ----- 2002 2001 -----  
 --- ----- (IN THOUSANDS) Proceeds  
 from  
 sales.....  
 \$1,304,494 \$518,935 Gross realized  
 gains.....  
 8,671 6,800 Gross realized  
 losses.....  
 -- (5)

SIX MONTHS ENDED JUNE 30, -----  
 ----- 2002 2001 -----  
 ---- ----- (IN THOUSANDS)  
 Proceeds from  
 sales.....  
 \$2,218,678 \$970,842 Gross realized  
 gains.....  
 14,935 12,911 Gross realized  
 losses.....  
 (2,772) (5)

### 4. DERIVATIVE FINANCIAL INSTRUMENTS

## Forward Exchange Contracts

The Company operates internationally, resulting in exposure to foreign exchange risk. This risk is primarily associated with costs payable in foreign currencies for employee compensation and for purchases from foreign suppliers. The Company's primary technique for minimizing its foreign exchange risk involves structuring customer contracts to provide for payment in both the U. S. dollar and the foreign currency whenever possible. The payment portion denominated in the foreign currency is based on anticipated foreign currency requirements over the contract term. In some instances, a foreign exchange forward contract is used to minimize the forward exchange risk. A forward exchange contract obligates the Company to exchange predetermined amounts of specified foreign currencies at specified foreign exchange rates on specified dates.

In June 2002 the Company entered into forward exchange contracts to purchase approximately 50.0 million Australian dollars; 4.2 million Australian dollars to be purchased monthly from August 29, 2002 through June 26, 2003 and 3.8 million to be purchased on July 31, 2003. In July 2001 the Company entered into twelve forward contracts to purchase 3.5 million Australian dollars each month from August 31, 2001 through July 31, 2002. These forward contracts are derivatives as defined by SFAS No. 133. SFAS No. 133 requires that each derivative be stated in the balance sheet at its fair value with gains and losses reflected in the income statement except that, to the extent the derivative qualifies for hedge accounting, the gains and losses are reflected in income in the same period as offsetting losses and gains on the qualifying hedged positions. SFAS No. 133 further provides specific criteria necessary for a derivative to qualify for hedge accounting. The forward exchange contracts purchased by the Company in 2002 and 2001 do not qualify for hedge accounting. At June 30, 2002, an asset of \$0.2 million, reflecting the fair value of the forward exchange contracts, was included with "Prepaid expenses and other" in the Consolidated Balance Sheet. A pre-tax gain of \$0.5 million (comprised of a \$0.6 million realized gain and a \$0.1 million unrealized loss) was recorded in the Consolidated Statements of Income for the quarter ended June 30, 2002 in "Other income (expense)." A pre-tax gain of \$1.2 million (comprised of a \$0.9 million realized gain and a \$0.3 million unrealized gain) was recorded in the Consolidated Statements of Income for the six months ended June 30, 2002 in "Other income (expense)." The Company had no forward exchange contracts during the first six months of 2001.

#### Contingent Interest

On April 11, 2001, the Company issued \$460.0 million principal amount of the 1.5% Debentures, which are due April 15, 2031 and contain a contingent interest provision (see Note 8). The contingent interest component is an embedded derivative as defined by SFAS No. 133 and accordingly must be split from the host instrument and recorded at fair value on the balance sheet. The contingent interest component had no value at issuance or at June 30, 2002.

#### 5. DRILLING AND OTHER PROPERTY AND EQUIPMENT

Cost and accumulated depreciation of drilling and other property and equipment are summarized as follows:

JUNE 30, DECEMBER 31, -----	2002	2001
-----		
- (IN THOUSANDS) Drilling rigs and equipment .....	\$ 2,921,281	\$ 2,732,333
Construction work-in-progress .....	90,070	163,308
Land and buildings .....	14,710	14,629
Office equipment and other .....	20,480	
Cost .....	19,731	
-----		
3,046,541 2,930,001 Less: accumulated depreciation .....	(1,014,410)	(927,128)
-----		
Drilling and other property and equipment, net ..	\$ 2,032,131	\$ 2,002,873
=====		

Construction work-in-progress at June 30, 2002, included \$59.1 million for the significant upgrade of the Ocean Rover to high specification capabilities.

In March 2002, \$157.4 million was reclassified from construction work-in-progress to drilling rigs and equipment upon completion of the significant upgrade of the Ocean Baroness to high specification capabilities. The Company took delivery of the Ocean Baroness in January 2002 and it was accepted by the customer on March 17, 2002 at which time it began its current contract offshore Malaysia. See "Ocean Baroness Update" in Item 2 of Part I of this report.

#### 6. GOODWILL

Goodwill from the merger with Arethusa in 1996 was generated from an excess of the purchase price over the net assets acquired. Prior to January 1, 2002 the Company was amortizing goodwill on a straight-line basis over 20 years. The Company adopted SFAS No. 142 on January 1, 2002 and, accordingly, has suspended amortization of goodwill in 2002.



JUNE 30, DECEMBER 31, -----		
-----	2002	2001
-----		(IN
THOUSANDS) Payroll and benefits		
.....	\$ 26,749	\$
25,880 Personal injury and other		
claims .....	27,993	25,471
Reserve for class action		
litigation ...	314	9,699
Interest payable		

.....	3,537	
1,645 Deferred revenue		
.....	6,845	
6,721 Other		
.....		
22,343	18,326	-----
	-----	Total
.....		\$ 87,781
\$ 87,742	=====	
	=====	

## 8. LONG-TERM DEBT

Long-term debt consists of the following:

JUNE 30, DECEMBER 31, -----	
----- 2002 2001 --	
----- (IN	
THOUSANDS) Zero coupon	
convertible debentures due 2020	
.... \$ 432,126 \$ 424,694	
Convertible senior debentures -	
1.5% due 2031 .. 460,000	
460,000 Ocean Alliance lease-	
leaseback agreement .....	
46,368 46,368 -----	
----- 938,494 931,062	
Less: Current maturities	
.....	
(10,426) (10,426) -----	
----- Total	
.....	
\$ 928,068 \$ 920,636	
=====	

## 9. COMMITMENTS AND CONTINGENCIES

Raymond Verdin, on behalf of himself and those similarly situated v. Pride Offshore, Inc., et al; C.A. No. G-01-168 in the United States District Court for the Southern District of Texas, Houston Division; formerly styled Raymond Verdin v. R&B Falcon Drilling USA, Inc., et al; No. G-00-488 in the United States District Court for the Southern District of Texas, Galveston Division, filed October 10, 2000. The Company was named as a defendant in a proposed class action suit filed on behalf of offshore workers against all of the major offshore drilling companies. The proposed class included persons hired in the United States by the companies to work in the Gulf of Mexico and around the world. The allegation was that the companies, through trade groups, shared information in violation of the Sherman Antitrust Act and various state laws. Plaintiff Thomas Bryant replaced the named plaintiff as the proposed class representative. The lawsuit was seeking money damages and injunctive relief as well as attorneys' fees and costs. During the first quarter of 2001, the Company recorded a \$10.0 million reserve for this pending litigation in the Company's Consolidated Statements of Income. In July 2001 the Company filed a stipulation of settlement with the District Court in which it agreed to settle the plaintiffs' outstanding claims for certain injunctive relief and a cash payment within the limits of the reserve. In April 2002 the United States District Judge for the Southern District of Texas, Houston Division, entered an order finally approving the proposed class action settlement and finally certifying the settlement class, and entered a final judgment and order of dismissal of this lawsuit. In June 2002 the Company made the final settlement payment of \$9.4 million from its reserve for this litigation.

Various other claims have been filed against the Company in the ordinary course of business, particularly claims alleging personal injuries. Management believes that the Company has established adequate reserves for any liabilities that may reasonably be expected to result from these claims. In the opinion of management, no pending or threatened claims, actions or proceedings against the Company are expected to have a material adverse effect on the Company's consolidated financial position, results of operations, or cash flows.

## 10. SEGMENTS AND GEOGRAPHIC AREA ANALYSIS

The Company reports its operations as one reportable segment, contract drilling of offshore oil and gas wells. Although the Company provides contract drilling services from different types of offshore drilling rigs and provides such services in many geographic locations, these operations have been aggregated into one reportable segment based on the similarity of economic characteristics among all divisions and locations, including the nature of services provided and the type of customers of such services.

## Similar Services

Revenues from external customers for contract drilling and similar services by equipment-type are listed below (eliminations offset dayrate revenues earned when the Company's rigs are utilized in its integrated services):

THREE MONTHS ENDED SIX MONTHS ENDED JUNE 30, JUNE 30, -----			
-----			
-	2002	2001	2002 2001 -
-----			
-----			
---- (IN THOUSANDS)			
High Specification			
Floaters ..	\$ 75,748	\$	
82,552	\$ 150,395	\$	
159,218	Other		
Semisubmersibles			
.....	73,977	97,062	
162,057	178,031	Jack-	
	ups		
.....			
26,839	47,490	56,339	
90,958	Integrated		
Services .....			
4,406	18 6,229	5,508	
	Other		
.....			
(436)	209	(436)	209
Eliminations			
..... (860)			
--	(1,242)	(1,368)	----
-----			
- Total revenues			
.....	\$ 179,674	\$	
227,331	\$ 373,342	\$	
432,556	=====		
	=====		
	=====		
	=====		

## Geographic Areas

At June 30, 2002, the Company had drilling rigs located offshore nine countries other than the United States. As a result, the Company is exposed to the risk of changes in social, political, economic and other conditions inherent in foreign operations and the Company's results of operations and the value of its foreign assets are affected by fluctuations in foreign currency exchange rates. Revenues by geographic area are presented by attributing revenues to the individual country or areas where the services were performed.

THREE MONTHS ENDED SIX MONTHS ENDED JUNE 30, JUNE 30, -----			
-----			
---	2002	2001	2002 2001
-----			
-----			
----- (IN THOUSANDS) Revenues from unaffiliated customers: United States			
.....			
\$ 69,483	\$ 146,458	\$	
161,193	\$ 273,498		
Foreign: Europe/Africa			
.....			
25,353	12,205	55,089	
	25,286		
Australia/Southeast Asia .....			
22,587	70,465	36,367	

South America			
.....			
44,745	46,081	86,595	
97,405	-----	--	
-----			
--	-----	Total	
revenues			
..... \$			
179,674	\$ 227,331	\$	
373,342	\$ 432,556		
=====			
=====			
=====			
=====			

11. OTHER INCOME AND EXPENSE (OTHER, NET)

Other, net consists of the following:

THREE MONTHS ENDED SIX MONTHS			
ENDED JUNE 30, JUNE 30, -----			
-----			
			2002
2001	2002	2001	-----
-----			
----- (IN THOUSANDS) Gain on			
sale of assets .....			
\$ 33	\$ 88	\$ 65	\$ 209 Reserve for
class action litigation ... -- -			
- -- (10,000) Settlement of			
litigation ..... -- --			
-- 7,284 Other			
.....			
449	132	1,317	(158) -----
-----			
----- Total other, net			
..... \$ 482 \$ 220 \$			
1,382	\$ (2,665)	=====	
=====			
=====			

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

The following discussion should be read in conjunction with the Company's Consolidated Financial Statements (including the Notes thereto) included elsewhere herein. References to the "Company" mean Diamond Offshore Drilling, Inc., a Delaware corporation, and its subsidiaries.

The Company is a leader in deep water drilling with a fleet of 45 offshore drilling rigs. The fleet consists of 30 semisubmersibles, 14 jack-ups and one drillship.

### RESULTS OF OPERATIONS

#### Recent Developments

On August 9, 2002, the Company's jack-up drilling unit the Ocean King, while conducting routine operations offshore Louisiana, experienced a well control event and fire. The rig's standing emergency action plan was initiated and all personnel on board the rig were safely evacuated. There were no reported injuries and no apparent pollution. The fire burned a short time and the rig was reboarded later that day by a limited crew. Early assessments reveal that damage was localized; primarily affecting electrical systems on the aft end of the cantilever structure. At this time, primary rig systems do not appear to be affected.

#### Ocean Baroness Update

On April 22, 2002 the Ocean Baroness experienced a parting of its marine riser during operations offshore Malaysia in 5,700 feet of water. No injuries were sustained and the well was secured without incident and successfully plugged. The drilling unit was undamaged and known damage was limited to subsurface elements of the riser. The rig resumed normal operations on May 19, 2002 after retrieving its marine riser. On May 30, 2002, the Company filed a lawsuit against the manufacturer of the marine riser seeking to recover damages the Company incurred as a result of the incident.

#### General

**Revenues.** The Company's revenues vary based upon demand, which affects the number of days the fleet is utilized and dayrates earned. When a rig is idle, generally no dayrate is earned and revenues will decrease as a result. Revenues can also increase or decrease as a result of the acquisition or disposal of rigs. In order to improve utilization or realize higher dayrates, the Company may mobilize its rigs from one market to another. During periods of mobilization, however, revenues may be adversely affected. As a response to changes in demand, the Company may withdraw a rig from the market by stacking it or may reactivate a rig stacked previously, which may decrease or increase revenues, respectively.

Revenues from dayrate drilling contracts are recognized currently. The Company may receive lump-sum payments in connection with specific drilling contracts. Such payments are recognized as revenues over the term of the related drilling contract. Mobilization revenues, less costs incurred to mobilize an offshore rig from one market to another, are recognized over the term of the related drilling contract.

Revenues from offshore turnkey contracts are accrued to the extent of costs until the specified turnkey depth and other contract requirements are met. Income is recognized on the completed contract method. Provisions for future losses on turnkey contracts are recognized when it becomes apparent that expenses to be incurred on a specific contract will exceed the revenue from that contract.

**Operating Income.** Operating income is primarily affected by revenue factors, but is also a function of varying levels of operating expenses. Operating expenses generally are not affected by changes in dayrates and may not be significantly affected by fluctuations in utilization. For instance, if a rig is to be idle for a short period of time, the Company may realize few decreases in operating expenses since the rig is typically maintained in a prepared state with a full crew. In addition, when a rig is idle, the Company is responsible for certain operating expenses such as rig fuel and supply boat costs, which are typically charged to the operator under drilling contracts. However, if the rig is to be idle for an extended period of time, the Company may reduce the size of a rig's crew and take steps to "cold stack" the rig, which lowers expenses and partially offsets the impact on operating income. The Company recognizes as operating expenses activities such as inspections, painting projects and routine overhauls, which meet certain criteria, that maintain rather than upgrade its

rigs. These expenses vary from period to period. Costs of rig enhancements are capitalized and depreciated over the expected useful lives of the enhancements. Increased depreciation expense decreases operating income in periods subsequent to capital upgrades.

THREE MONTHS ENDED JUNE 30, 2002 AND 2001

Comparative data relating to the Company's revenues and operating expenses by equipment type are listed below (eliminations offset (i) dayrate revenues earned when the Company's rigs are utilized in its integrated services and (ii) intercompany expenses charged to rig operations). Certain amounts applicable to the prior periods have been reclassified to conform to the classifications currently followed. Such reclassifications do not affect earnings.

```

THREE MONTHS ENDED JUNE 30, -----
----- INCREASE/
2002 2001 (DECREASE) -----
----- (IN
THOUSANDS) REVENUES High
Specification Floaters
..... $ 75,748 $ 82,552 $
(6,804) Other Semisubmersibles
..... 73,977 97,062
(23,085) Jack-ups
.....
26,839 47,490 (20,651) Integrated
Services .....
4,406 18 4,388 Other
.....
(436) 209 (645) Eliminations
..... (860)
-- (860) -----
- ----- Total Revenues
..... $ 179,674 $
227,331 $ (47,657) =====
=====
CONTRACT DRILLING EXPENSE High
Specification Floaters
..... $ 39,325 $ 31,520 $
7,805 Other Semisubmersibles
..... 53,060 55,983
(2,923) Jack-ups
.....
22,678 26,318 (3,640) Integrated
Services .....
4,689 (181) 4,870 Other
.....
700 916 (216) Eliminations
..... (860)
-- (860) -----
- ----- Total Contract
Drilling Expense .. $ 119,592 $
114,556 $ 5,036 =====
=====
OPERATING INCOME High Specification
Floaters ..... $ 36,423 $
51,032 $ (14,609) Other
Semisubmersibles
..... 20,917 41,079
(20,162) Jack-ups
.....
4,161 21,172 (17,011) Integrated
Services .....
(283) 199 (482) Other
.....
(1,136) (707) (429) Depreciation
and Amortization Expense ....
(44,585) (42,171) (2,414) General
and Administrative Expense .....
(7,440) (6,079) (1,361) -----
-- -----
Total Operating Income .....
$ 8,057 $ 64,525 $ (56,468)
=====
=====

```

High Specification Floaters.

Revenues. Revenues from high specification floaters decreased \$6.8 million during the quarter ended June 30, 2002 compared to the same quarter of 2001. Lower utilization in 2002 accounted for \$11.3 million of the decrease (excluding the Ocean Baroness). Utilization for this class of rig dropped from 96% during the second quarter of 2001 to 82% during the second quarter of 2002 (excluding

the Ocean Baroness). The Ocean America was idle for a majority of the second quarter of 2002 and was responsible for \$9.0 million of the decline. Lower utilization of the Ocean Star, which spent approximately one month in a shipyard for inspection and repairs in 2002, resulted in reduced revenues of \$3.2 million.

A decline in average operating dayrates, which fell from \$117,700 per day for the second quarter of 2001 to \$108,100 per day for the second quarter of 2002 (excluding the Ocean Baroness), caused \$7.0 million of the overall revenue reduction. The most significant decreases in dayrates were experienced by the Ocean Valiant (\$41,200), the Ocean Star (\$32,300) and the Ocean Victory (\$27,100).

Partially offsetting the overall decrease in revenues was \$11.5 million generated by the Ocean Baroness, which began operations in mid-March 2002 upon completion of its upgrade to high specification capabilities.

Contract Drilling Expense. Contract drilling expense for high specification floaters during the quarter ended June 30, 2002 increased \$7.8 million from the same period in 2001 primarily due to \$6.7 million of expenses from the Ocean Baroness. Contract drilling expense for the Ocean Baroness included costs incurred in connection with the recovery of its marine riser, net of costs charged to an associated insurance claim, as well as its normal operating

costs. See "-- Ocean Baroness Update." Contract drilling expense for the Ocean America increased \$1.3 million over the second quarter of 2001 due to various maintenance projects performed while the rig was idle and mobilization costs incurred when the rig returned to work at the end of the second quarter of 2002. Contract drilling expense for the Ocean Star was \$0.9 million higher in the second quarter of 2002 as a result of its inspection and repairs while in a shipyard. Lower spending for maintenance and repairs in the second quarter of 2002 by several other high specification floaters partially mitigated these unfavorable variances.

#### Other Semisubmersibles.

Revenues. Revenues from other semisubmersibles for the quarter ended June 30, 2002 decreased \$23.1 million from the same period in 2001. A decline in utilization accounted for \$21.1 million of this decrease as utilization fell to 54% in the second quarter of 2002 from 75% in the same period of 2001. The Ocean Voyager and the Ocean Endeavor were both cold stacked the entire second quarter of 2002 but worked most of the second quarter of 2001. The Ocean New Era, Ocean Ambassador, Ocean Lexington and the Ocean Saratoga were each idle more days in the second quarter of 2002 than in the same period of 2001. The Ocean General was in a shipyard for approximately one month during the second quarter of 2002 for an inspection and preparation for its mobilization to Vietnam but worked the entire second quarter of 2001. Partially offsetting these revenue decreases were utilization improvements for the Ocean Princess, Ocean Whittington, and Ocean Guardian, all of which worked more days in the second quarter of 2002 than in the same period of 2001.

Of the \$23.1 million revenue decline in the second quarter of 2002, \$2.0 million resulted from lower overall dayrates earned by the other semisubmersible rig fleet. However, the average operating dayrate for this fleet increased from \$65,000 during the second quarter of 2001 to \$71,500 during the second quarter of 2002. This occurred because several of the rigs that were contracted at lower dayrates in the second quarter of 2001 were stacked throughout the second quarter of 2002. Consequently, the average operating dayrate rose in 2002 for the working rigs in this category. Significant changes in operating dayrates included the Ocean Worker which decreased approximately \$83,100, and the Ocean Guardian and Ocean Princess which increased approximately \$33,300 and \$35,300, respectively.

Contract Drilling Expense. Contract drilling expense for other semisubmersibles decreased \$2.9 million during the quarter ended June 30, 2002 compared to the same quarter of 2001. Contract drilling expense was \$4.6 million lower than the same period in 2001 as a result of cold stacking the Ocean Voyager and Ocean Endeavor in 2002. Cost savings of \$1.2 million were achieved by reducing crews on the Ocean New Era and the Ocean Ambassador, both of which were stacked during the second quarter of 2002. Partially offsetting the expense reductions were increased expenses of \$1.3 million for inspection and repair and the mobilization of the Ocean General to Vietnam and \$0.7 million for equipment maintenance and repairs on the Ocean Liberator.

#### Jack-Ups.

Revenues. Revenues from jack-ups decreased \$20.7 million in the second quarter of 2002 compared to the same period in 2001. Average operating dayrates of \$28,700 during the second quarter of 2002, down from \$43,700 during the first quarter of 2001, resulted in \$12.3 million of the decrease. All of the Company's jack-up rigs, except one, experienced lower average dayrates in the second quarter of 2002. The average dayrate of the exception, the Ocean Heritage, increased \$47,300 from the second quarter of 2001 to the second quarter of 2002 and contributed \$3.9 million to revenues. In addition, the Ocean Heritage received a \$2.4 million demobilization fee upon completion of its contract in Australia in the second quarter of 2002.

Revenues decreased \$8.4 million as a result of a decline in utilization for the Company's jack-up fleet to 74% for the quarter ended June 30, 2002 from 85% for the same period in 2001. Utilization for the Ocean Spartan and the Ocean Spur was down for the second quarter of 2002 as both rigs were undergoing leg extension upgrades during the period. Utilization also declined for the Ocean Champion which was cold stacked during the second quarter of 2002 but worked the entire second quarter of 2001. Utilization improved for the Ocean Sovereign, which worked throughout the second quarter of 2002 but spent the entire second quarter of 2001 in a shipyard for repairs, partially offsetting the revenue decline.

Contract Drilling Expense. Contract drilling expense for jack-ups during the second quarter of 2002 decreased \$3.6 million compared to the same period in 2001. Contract drilling expense for the Ocean Spartan and the Ocean Spur was lower by \$2.4 million for the second quarter of 2002 as a result of capitalizing

costs while these rigs were in a shipyard for leg extension upgrades. Contract drilling expense for the Ocean Champion, cold stacked during

the second quarter of 2002, decreased \$1.8 million from the same quarter in 2001. Partially offsetting this decrease, the Ocean Heritage experienced an increase in contract drilling expenses of \$0.6 million from higher labor costs while working in Australia during the second quarter of 2002 compared to the labor costs incurred while working in Indonesia during the second quarter of 2001.

#### Integrated Services.

Operating income for integrated services decreased in the second quarter of 2002 compared to the second quarter of 2001 as a result of the difference in type and magnitude of projects during those periods. During the second quarter of 2002, an integrated services' operating loss of \$0.3 million resulted from two turnkey wells in the Gulf of Mexico. During the same period in 2001, operating income of \$0.2 million was primarily due the completion of one international turnkey project.

#### Depreciation and Amortization Expense.

Depreciation and amortization expense for the second quarter of 2002 increased \$2.4 million over the second quarter of 2001. Higher 2002 depreciation resulted primarily from an increase in capital additions and additional depreciation for the Ocean Baroness, which completed its deepwater upgrade and began operations in March 2002. The suspension of goodwill amortization on January 1, 2002 partially offset this increase. See Note 1 "--Goodwill" and Note 6 of the Company's Consolidated Financial Statements in Item 1 of Part I of this report.

#### General and Administrative Expense.

General and administrative expense for the second quarter of 2002 of \$7.4 million increased \$1.3 million over \$6.1 million for the second quarter of 2001. This increase was primarily due to higher personnel costs and professional expenses in the current quarter.

#### Interest Income.

Interest income of \$7.7 million for the quarter ended June 30, 2002 decreased \$3.9 million from \$11.6 million for the same period in 2001 primarily due to lower interest rates earned on invested cash and marketable securities in 2002. Interest expense of \$0.4 million incurred in connection with the Company's repurchase agreements also contributed to the decrease in the quarter ended June 30, 2002. See Note 1 "--Securities Sold Under Agreements to Repurchase" in Item I of Part I of this report.

#### Interest Expense.

Interest expense of \$6.3 million for the quarter ended June 30, 2002 decreased \$11.7 million from \$18.0 million for the same period in 2001 primarily due to the \$ 11.9 million pre-tax loss from the April 2001 redemption of the Company's 3.75% Convertible Subordinated Notes Due 2007 ("3.75% Notes"). In addition, the Company's interest rate in 2002 was lower than in 2001 resulting from the redemption of the 3.75% Notes in 2001 and the issuance of the 1.5% Convertible Senior Debentures due 2031 (the "1.5% Debentures") on April 11, 2001. Interest capitalized to rig upgrades in the second quarter of 2002 decreased compared to the same period in 2001 and partially offset the decrease in interest expense.

#### Income Tax Expense.

Income tax expense of \$6.6 million for the quarter ended June 30, 2002 decreased \$14.8 million from \$21.4 million for the same period in 2001 primarily as a result of the \$46.6 million decrease in "Income before income tax expense" in the second quarter of 2002.

The 35.6% effective income tax rate for the second quarter of 2002 resulted from a revision of the estimated annual effective tax rate from 30.6% anticipated in the first quarter of 2002 to 32.4% in the second quarter of 2002. The Company indefinitely reinvests the earnings of its U.K. subsidiaries and, accordingly, provides no deferred U.S. income taxes on these earnings. The tax rate in the U.K. is lower than the U.S. statutory rate. During the second quarter of 2002, the full year projected earnings of the Company's U.K. subsidiaries changed relative to the Company's projected worldwide earnings. Second quarter 2002 tax expense includes an adjustment to bring the effective tax rate for the full year to 32.4%.



SIX MONTHS ENDED JUNE 30, 2002 AND 2001

Comparative data relating to the Company's revenues and operating expenses by equipment type are listed below (eliminations offset (i) dayrate revenues earned when the Company's rigs are utilized in its integrated services and (ii) intercompany expenses charged to rig operations). Certain amounts applicable to the prior periods have been reclassified to conform to the classifications currently followed. Such reclassifications do not affect earnings.

```

SIX MONTHS ENDED JUNE 30, -----
----- INCREASE/
2002 2001 (DECREASE) -----
----- (IN
THOUSANDS) REVENUES High
Specification Floaters
..... $ 150,395 $ 159,218
$ (8,823) Other Semisubmersibles
..... 162,057 178,031
(15,974) Jack-ups
.....
56,339 90,958 (34,619) Integrated
Services .....
6,229 5,508 721 Other
.....
(436) 209 (645) Eliminations
.....
(1,242) (1,368) 126 ----- -
----- Total
Revenues ..... $
373,342 $ 432,556 $ (59,214)
=====
===== CONTRACT DRILLING
EXPENSE High Specification Floaters
..... $ 74,648 $ 59,579 $
15,069 Other Semisubmersibles
..... 109,588 106,470
3,118 Jack-ups
.....
48,287 51,703 (3,416) Integrated
Services .....
7,530 4,974 2,556 Other
.....
1,105 1,895 (790) Eliminations
.....
(1,242) (1,368) 126 ----- -
----- Total
Contract Drilling Expense .. $
239,916 $ 223,253 $ 16,663
=====
===== OPERATING INCOME High
Specification Floaters
..... $ 75,747 $ 99,639 $
(23,892) Other Semisubmersibles
..... 52,469 71,561
(19,092) Jack-ups
.....
8,052 39,255 (31,203) Integrated
Services .....
(1,301) 534 (1,835) Other
.....
(1,541) (1,686) 145 Depreciation
and Amortization Expense ....
(87,282) (83,730) (3,552) General
and Administrative Expense .....
(14,088) (12,966) (1,122) -----
-----
Total Operating Income .....
$ 32,056 $ 112,607 $ (80,551)
=====
=====

```

High Specification Floaters.

Revenues. Revenues from high specification floaters during the six months ended June 30, 2002 decreased \$8.8 million from the same period in 2001. A decline in utilization accounted for \$14.5 million of the decrease as utilization declined from 96% during the first six months of 2001 to 85% (excluding the Ocean Baroness) during the same period in 2002. Utilization for

the Ocean America declined as the rig was idle for most of the first half of 2002. In addition, the Ocean Star spent three months in 2002 in a shipyard for inspection and repairs but worked all of the first six months of 2001.

Lower average operating dayrates accounted for \$8.2 million of the decrease in revenue for this classification of rig. Average dayrates fell from \$115,000 during the six months ended June 30, 2001 to \$111,500 (excluding the Ocean Baroness) during the same period in 2002. The most significant dayrate decreases were experienced by the Ocean Valiant (\$36,700) and the Ocean Victory (\$20,700). These decreases were partially offset by an increase in the average operating dayrate for the Ocean America from \$98,800 to \$118,000 per day.

The Ocean Baroness, which began operations in mid-March 2002 after completing an upgrade to high specification capabilities, contributed \$13.9 million to revenue during the first half of 2002.

Contract Drilling Expense. Contract drilling expense for high specification floaters during the six months ended June 30, 2002 increased \$15.1 million from the same period in 2001. Operating expenses for the Ocean Baroness added \$7.5 million to contract drilling expense in the first six months of 2002 and included costs incurred in connection with the recovery of its marine riser, net of costs charged to an associated insurance claim, as well as

its normal operating costs. See "-- Ocean Baroness Update." Mobilization to and from the shipyard for inspection and repairs of the Ocean Star in 2002 resulted in increased expenses of \$2.0 million. Higher Brazilian customs fees in 2002 for the importation of spare parts and supplies for the Ocean Alliance and the Ocean Clipper were responsible for increased costs of \$1.5 million. The 2001 recognition of a \$1.8 million revision to an estimated insurance deductible for the Ocean Clipper also contributed to the cost increase in 2002.

#### Other Semisubmersibles.

Revenues. Revenues from other semisubmersibles for the six months ended June 30, 2002 decreased \$16.0 million from the same period in 2001. A decline in utilization accounted for \$15.7 million of the decrease as utilization dropped from 69% for the first half of 2001 to 61% for the first half of 2002. During part of the first half of 2002 the Ocean Worker was in a shipyard for inspection and repairs and the Ocean Saratoga was in a shipyard for repairs, while both rigs worked most of the first half of 2001. The Ocean Ambassador and the Ocean General were stacked for more days in the first half of 2002 than in the same period in 2001 and the Ocean Voyager and the Ocean Endeavor were cold stacked in March 2002. An improvement in utilization for the Ocean Nomad, which worked most of the first half of 2002 but spent most of the first half of 2001 in a shipyard undergoing stability enhancements and other upgrades, was partially offsetting.

Revenues in the first half of 2002 were not significantly affected by the overall change in dayrates from the same period in 2001. However, the average operating dayrate increased from \$64,900 for the first half of 2001 to \$69,400 during the first half of 2002. Several of the rigs that were contracted at lower dayrates worked in 2001 but were stacked throughout the first half of 2002. Consequently, the average operating dayrate has increased in 2002 for the working rigs in this category. Significant changes in average operating dayrates included the Ocean Worker and the Ocean Whittington, which decreased \$63,600 and \$30,400, respectively, and the Ocean Guardian and the Ocean Princess, which increased \$36,700 and \$33,200, respectively.

Contract Drilling Expense. Contract drilling expense for other semisubmersibles was \$3.1 million higher in the first half of 2002 than in the same period in 2001. The mobilization of the Ocean Worker to a shipyard for inspection and repairs added \$2.5 million to contract drilling expense in 2002. Contract drilling expense for the Ocean Nomad was \$2.1 million higher in the first half of 2002 primarily due to a reduction in costs in the first half of 2001 resulting from capitalizing costs while the rig was in a shipyard for an upgrade. An increase in Brazilian customs fees for the importation of spare parts and supplies for the Ocean Yatzy, Ocean Yorktown and the Ocean Winner resulted in a \$1.5 million increase to contract drilling expense. The inspection, repair and mobilization of the Ocean General to Vietnam and repairs to the Ocean Liberator added \$1.2 million and \$0.7 million, respectively, to contract drilling expense during the first half of 2002. Partially offsetting these increases were cost reductions of \$5.6 million resulting from cold stacking the Ocean Endeavor and the Ocean Voyager in the first half of 2002.

#### Jack-Ups.

Revenues. Revenues from jack-ups decreased \$34.6 million in the first half of 2002 compared to the same period in 2001. Average operating dayrates of \$29,300 during the first half of 2002, down from \$41,800 during the first half of 2001, resulted in a \$23.6 million decline in revenue. For this rig classification, only the Ocean Heritage experienced a substantial increase in average dayrate of \$31,400 from the first half of 2001 to the first half of 2002. In addition, the Ocean Heritage received a \$4.7 million mobilization fee in connection with its contract in Australia during 2002.

Revenues decreased \$11.0 million as a result of a decline in utilization to 82% in the first six months of 2002 from 86% for the same period in 2001. Utilization was down for the Ocean Champion, which was idle and/or cold stacked the entire first half of 2002, and for the Ocean Spartan and the Ocean Spur, which began their leg extension upgrades during 2002. All three of these jack-ups were working in the first half of 2001. Higher utilization in 2002 for the Ocean Sovereign, which worked the entire first half of 2002 but spent most of the first half of 2001 in a shipyard for repairs, was partially offsetting.

Contract Drilling Expense. Contract drilling expense for jack-ups decreased \$3.4 million in the first six months of 2002 compared to the same period in 2001. Contract drilling expense was lower in 2002 for the Ocean Spartan and the Ocean Spur as a result of capitalizing costs while these rigs were being upgraded and for the Ocean Champion which was idle and/or cold stacked during the first half of 2002. Increased contract drilling expense during the first half of 2001 from repairs to the Ocean Nugget, the Ocean Crusader, and the Ocean Summit also



contributed to this decrease. Higher expenses for the Ocean Heritage in 2002, primarily due to the mobilization of the rig from Indonesia to Australia and higher labor costs in Australia, were partially offsetting.

#### Integrated Services.

Operating income for integrated services decreased in the first half of 2002 compared to the first half of 2001 as a result of the difference in type and magnitude of projects during those periods. During the first six months of 2002, an integrated services' operating loss of \$1.3 million resulted from two turnkey wells in the Gulf of Mexico. During the same period in 2001, operating income of \$0.5 million was primarily due the completion of one international turnkey project.

#### Depreciation and Amortization Expense.

Depreciation and amortization expense for the six months ended June 30, 2002 increased \$3.6 million over the first half of 2001. Higher depreciation in 2002 resulted primarily from an increase in capital additions and additional depreciation for the Ocean Baroness, which completed its deepwater upgrade and began operations in March 2002. The suspension of goodwill amortization on January 1, 2002 partially offset this increase. See Note 1 "--Goodwill" and Note 6 to the Company's Consolidated Financial Statements in Item 1 of Part I of this report.

#### General and Administrative Expense.

General and administrative expense for the six months ended June 30, 2002 of \$14.1 million increased \$1.1 million over \$13.0 million for the same period in 2001. This increase was primarily due to higher personnel costs and professional expenses in the first half of 2002.

#### Interest Income.

Interest income of \$17.2 million for the six months ended June 30, 2002 decreased \$6.1 million from \$23.3 million for the same period in 2001 primarily due to lower interest rates earned on invested cash and marketable securities in 2002. Interest expense of \$0.7 million incurred in connection with the Company's repurchase agreements also contributed to the decrease. See "--Securities Sold Under Agreements to Repurchase" in Item I of Part I of this report.

#### Interest Expense.

Interest expense of \$11.8 million for the six months ended June 30, 2002 decreased \$14.5 million from \$26.3 million for the same period in 2001 primarily due to the \$ 11.9 million pre-tax loss from the April 2001 redemption of the Company's 3.75% Notes. In addition, the Company's interest rate in 2002 was lower than in 2001 resulting from the redemption of the 3.75% Notes in 2001 and the issuance of the 1.5% Convertible Senior Debentures due 2031 (the "1.5% Debentures") on April 11, 2001. Higher interest capitalized to the Ocean Baroness and Ocean Rover upgrades also contributed to reduced interest expense during the first half of 2002 compared to the same period in 2001. See "--Liquidity."

#### Other Income and Expense (Other, net).

Other income of \$1.4 million for the six months ended June 30, 2002 increased \$4.1 million from other expense of \$2.7 million for the same period in 2001. Other income in the first half of 2002 resulted primarily from a \$1.2 million pre-tax gain on forward exchange contracts. Other expense in the first half of 2001 included a \$10.0 million expense associated with a reserve for class action litigation partially offset by a \$7.3 million receipt for settled litigation.

#### Income Tax Expense.

Income tax expense of \$16.6 million for the six months ended June 30, 2002 decreased \$22.6 million from \$39.2 million for the same period in 2001 primarily as a result of the \$68.7 million decrease in "Income before income tax expense" in the first half of 2002 compared to the same period in 2001.

## OUTLOOK

Oil and natural gas prices have stabilized considerably from early 2002 and late 2001 and, historically, there has been a strong correlation between these product prices and the demand for the Company's services. However, the Company believes that its customers continue to lack confidence in the sustainability of the current prices and therefore expects the market to remain relatively fragile in the near term. If product prices continue to exhibit signs of stability, then the Company anticipates a slow, modest growth in drilling activity through year-end.

Given the current market environment, the Company anticipates reasonable utilization among its deepwater rigs and other active floaters in the Gulf of Mexico. However, work will be almost exclusively short term and therefore periodic idle time is likely.

The Company expects its jack-up business to remain stable with modest upward pressure on rates throughout the rest of the year. Furthermore, the Company anticipates that the rigs currently undergoing shipyard upgrades will emerge to a market that has improved since these rigs entered shipyards in the first and second quarters of this year.

Internationally, the Company expects its business to remain relatively stable in most regions, with the exception of the North Sea, where downward pressure is expected.

## LIQUIDITY

### Operating Activities.

At June 30, 2002, the Company's cash and marketable securities totaled \$1.2 billion, up from \$1.1 billion at December 31, 2001. Cash of \$252.2 million and \$199.1 million generated by repurchase agreements is included at June 30, 2002 and December 31, 2001, respectively. Cash provided by operating activities for the six months ended June 30, 2002 increased by \$26.8 million to \$165.6 million, compared to \$138.8 million for the same period in 2001. This increase in cash was primarily attributable to a \$98.1 million increase in cash provided by changes in net working capital components in the first half of 2002. Net income, after adjustment for non-cash items, resulted in a decrease in cash of \$71.3 million.

### Investing Activities.

Investing activities used \$61.7 million of cash during the first six months of 2002, compared to \$149.8 million of cash used during the same period in 2001. The \$88.1 million decrease in cash usage was primarily due to \$53.1 million provided by securities sold under repurchase agreements in 2002. In addition, \$0.7 million was provided by the net sales of certain of the Company's investments in marketable securities in the first half of 2002 compared to the same period in 2001 when \$54.5 million was used for net purchases of investments. Also, cash provided by investing activities included \$1.3 million in proceeds from the sale of assets (an increase of \$0.2 million over 2001) and \$0.9 million from the settlement of forward contracts entered into in July 2001. Other sources of cash usage for the first half of 2002 included \$117.8 million used for capital expenditures primarily for the Ocean Baroness and Ocean Rover upgrades, an increase of \$21.4 million over the same period in 2001.

### Financing Activities.

Financing activities used \$54.1 million of cash during the six months ended June 30, 2002 compared to \$23.5 million of cash provided in the same period of 2001. Depending on market conditions, the Company may, from time to time, purchase shares of its common stock or issue put options in the open market or otherwise. During the first half of 2002, the Company purchased 500,000 shares of its common stock at an aggregate cost of \$20.0 million, or \$40.00 per share, upon the exercise of put options sold in February 2001. See "--Treasury Stock and Common Equity Put Options" in Note 1 to the Company's Consolidated Financial Statements in Item 1 of Part I of this report. During the six months ended June 30, 2001, the Company purchased 100,000 shares of its common stock, which settled on July 3, 2001, at an aggregate cost of \$3.3 million or at an average cost of \$33.00 per share. In August 2002 the Company purchased 70,000 shares of its common stock at an aggregate cost of \$1.4 million, or at an average cost of \$20.59 per share.

Cash used in financing activities in the first half of 2002 also included payments totaling \$1.2 million for the settlement of put options which covered 1,000,000 shares of the Company's common stock. Financing activities in the first half of 2001 provided cash from premiums of \$3.1 million received from the sale of put options covering



500,000 shares of the Company's common stock. The options gave the holders the right to require the Company to repurchase up to the contracted number of shares of its common stock at the stated exercise price per share at any time prior to their expiration. The Company had the option to settle in cash or shares of its common stock. Put options sold in 2001 which covered 187,321 shares of the Company's common stock, expired during the first half of 2002. See "--Treasury Stock and Common Equity Put Options" in Note 1 to the Company's Consolidated Financial Statements in Item 1 of Part I of this report.

Financing activities in the first six months of 2002 also used \$33.0 million for dividends paid to stockholders compared to \$33.3 million in 2001.

Cash provided by financing activities for the first six months of 2001 consisted primarily of net proceeds of \$449.4 million from the issuance of \$460.0 million principal amount of the 1.5% Debentures on April 11, 2001.

The primary source of cash usage for financing activities in 2001 resulted from the Company's redemption of all of its outstanding 3.75% Notes in accordance with the indenture under which they were issued. The Company redeemed the outstanding 3.75% Notes at 102.8% of the principal amount thereof plus accrued interest for a total cash payment of \$397.7 million, resulting in an \$11.9 million loss which is reported in "Interest expense" in the Consolidated Statements of Income.

Other.

The Company has the ability to issue an aggregate of approximately \$117.5 million in debt, equity and other securities under a shelf registration statement. In addition, the Company may issue, from time to time, up to eight million shares of common stock, which shares are registered under an acquisition shelf registration statement (upon effectiveness of an amendment thereto reflecting the effect of the two-for-one stock split declared in July 1997), in connection with one or more acquisitions by the Company of securities or assets of other businesses.

The Company believes it has the financial resources needed to meet its business requirements in the foreseeable future, including capital expenditures for rig upgrades and continuing rig enhancements, and working capital requirements.

#### CAPITAL RESOURCES

Cash required to meet the Company's capital commitments is determined by evaluating the need to upgrade rigs to meet specific customer requirements and by evaluating the Company's ongoing rig equipment replacement and enhancement programs, including water depth and drilling capability upgrades. It is management's opinion that operating cash flows and the Company's cash reserves will be sufficient to meet these capital commitments; however, the Company will continue to make periodic assessments based on industry conditions. In addition, the Company may, from time to time, issue debt or equity securities, or a combination thereof, to finance capital expenditures, the acquisition of assets and businesses or for general corporate purposes. The Company's ability to affect any such issuance will be dependent on the Company's results of operations, its current financial condition, current market conditions and other factors beyond its control.

During the first half of 2002, the Company spent \$93.1 million, including capitalized interest expense, for rig upgrades, of which \$38.3 million was for the conversion of the Ocean Rover and \$30.1 million was for the completion of the conversion of the Ocean Baroness. The Company spent \$22.5 million in the first six months of 2002 to upgrade six of the Company's jack-up rigs. The Company expects to spend approximately \$275 million for rig upgrade capital expenditures during 2002 primarily for upgrades of the Ocean Rover and six jack-up rigs.

The Ocean Rover, one of the Company's Victory-class semisubmersibles, arrived at a shipyard in Singapore for a major upgrade in mid-January 2002. The completed upgrade will include the following enhancements: capability for operation in 7,000-foot water depths on a stand alone basis; approximately 5,590 metric tons variable deckload; a 15,000 psi blow-out prevention system; 3,600-kips riser tensioning and riser with a multiplex control system. Additional features, including a high capacity deck crane, significantly enlarged cellar deck area and a 25-by 91-foot moon pool, will provide enhanced subsea completion and development capabilities. Water depths in excess of 7,000 feet should be achievable utilizing preset taut-leg mooring systems on a case by case basis. The upgrade is estimated to cost approximately \$200 million with approximately \$135 million to be spent in 2002. The upgrade is expected to take approximately 19 months to complete with delivery estimated in the third quarter



The significant upgrade of the Company's semisubmersible rig, the Ocean Baroness, to high specification capabilities has resulted in an enhanced version of the Company's previous Victory-class upgrades. The upgrade was similar to the upgrade currently being performed on the Ocean Rover. The Company took delivery of the Ocean Baroness in January 2002 and it was accepted by the customer on March 17, 2002, at which time it began its current contract offshore Malaysia. The approximate cost of the upgrade was \$170 million. See "--Ocean Baroness Update."

The Company also expects to spend approximately \$100 million to significantly upgrade six of its 14 jack-up rigs over the next two years to expand the shallow water fleet's capabilities. The Ocean Titan and Ocean Tower, both 350-foot water depth capability independent-leg slot rigs, are scheduled to have cantilever packages installed. The cantilever systems enable a rig to cantilever or extend its drilling package over the aft end of the rig. This is particularly important when attempting to drill over existing platforms. Cantilever rigs have historically enjoyed higher dayrates and greater utilization compared to slot rigs. The Ocean Spartan, Ocean Spur, Ocean Sovereign and the Ocean Heritage, all 250-foot water depth capability independent-leg cantilever rigs, are scheduled to have leg extensions installed enabling these rigs to work in water depths up to 300 feet. The Ocean Spartan, Ocean Spur and Ocean Heritage are currently in shipyards with their leg extension upgrades at various stages of completion. Upgrades planned for the Ocean Titan and Ocean Tower are expected to commence later in 2002. The upgrade of the Ocean Sovereign will commence in late 2002 or early 2003 once its current commitments have been met. The Company expects to finance these upgrades through the use of existing cash balances or internally generated funds.

During the six months ended June 30, 2002, the Company spent \$24.7 million in association with its continuing rig enhancement program and to meet other corporate capital expenditure requirements. These expenditures included purchases of drill pipe, anchor chain, riser, cranes, and other drilling equipment. The Company has budgeted \$100.0 million for 2002 capital expenditures associated with its continuing rig enhancement program (other than rig upgrades) and other corporate requirements.

The Company continues to consider opportunities, which include, but are not limited to, the purchase of existing rigs, construction of new rigs and the acquisition of other companies engaged in contract drilling or related businesses. Certain of these potential transactions reviewed by the Company would, if completed, result in its entering new lines of business. In general, however, these opportunities have been related in some manner to the Company's existing operations. Although the Company does not, as of the date hereof, have any commitment with respect to a material acquisition, it could enter into such an agreement in the future and such acquisition could result in a material expansion of its existing operations or result in its entering a new line of business. Some of the potential acquisitions considered by the Company could, if completed, result in the expenditure of a material amount of funds or the issuance of a material amount of debt or equity securities.

#### INTEGRATED SERVICES

The Company's wholly owned subsidiary, Diamond Offshore Team Solutions, Inc. ("DOTS"), from time to time, selectively engages in drilling services pursuant to turnkey or modified-turnkey contracts under which DOTS agrees to drill a well to a specified depth for a fixed price. In such cases, DOTS generally is not entitled to payment unless the well is drilled to the specified depth and other contract requirements are met. Profitability of the contract is dependent upon its ability to keep expenses within the estimates used in determining the contract price. Drilling a well under a turnkey contract therefore typically requires a greater cash commitment by the Company and exposes the Company to risks of potential financial losses that generally are substantially greater than those that would ordinarily exist when drilling under a conventional dayrate contract. DOTS also offers a portfolio of drilling services including overall project management, extended well tests, and completion operations. During the six months ended June 30, 2002, DOTS had an operating loss of \$1.3 million, primarily from two domestic turnkey projects. During the same period in 2001, DOTS provided turnkey and integrated services resulting in operating income of \$0.5 million, primarily from the completion of one international turnkey project.

## ACCOUNTING STANDARDS

In July 2002 the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. SFAS No. 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. The Company does not expect the adoption of SFAS No. 146 to have a material impact on the Company's consolidated results of operations, financial position or cash flows.

In April 2002 the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment to FASB Statement No. 13, and Technical Corrections." The rescission of SFAS No. 4 and 64 by SFAS No. 145 streamlines the reporting of debt extinguishments and requires that only gains and losses from extinguishments meeting the criteria in Opinion 30 would be classified as extraordinary. Thus, gains or losses arising from extinguishments that are part of a company's recurring operations would not be reported as an extraordinary item. SFAS No. 145 is effective for fiscal years beginning after May 15, 2002 with earlier adoption encouraged. The Company adopted SFAS No. 145 in April 2002 and, accordingly, reclassified its April 2001 loss of \$7.7 million, net-of-tax, from early extinguishment of debt, as a result of the Company's redemption of the outstanding 3.75% Notes, out of extraordinary items. The pre-tax loss from early extinguishment of debt of \$11.9 million was reclassified to "Interest expense." The related tax benefit was reclassified to "Income tax expense."

In October 2001 the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 replaces SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" and provides updated guidance concerning the recognition and measurement of an impairment loss for certain types of long-lived assets. SFAS No. 144 is effective for fiscal years beginning after December 15, 2001 with earlier application encouraged. The Company's adoption of SFAS No. 144 in January 2002 has not had, nor is it expected to have, a material impact on the Company's consolidated results of operations, financial position or cash flow.

In August 2001 the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 addresses financial accounting and reporting obligations associated with the retirement of tangible, long-lived assets and their associated asset retirement costs. SFAS No. 143 is effective for fiscal years beginning after June 15, 2002 with early adoption encouraged. Adoption of SFAS No. 143 in 2003 is not expected to have a material impact on the Company's consolidated results of operations, financial position or cash flow.

In June 2001 the FASB issued two new pronouncements, SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires that all business combinations be accounted for by the purchase method and applies to all business combinations initiated after June 30, 2001 and also applies to all business combinations accounted for using the purchase method for which the date of acquisition is July 1, 2001 or later. There are also transition provisions that apply to business combinations completed before July 1, 2001, that were accounted for by the purchase method. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001 for all goodwill and other intangible assets recognized in an entity's statement of financial position at that date, regardless of when those assets were initially recognized. The Company adopted SFAS No. 142 on January 1, 2002 and has suspended amortization of goodwill. The adoption of SFAS No. 142 has not had, nor is it expected to have, a material impact on the Company's consolidated results of operations, financial position or cash flow. See Note 6 to the Company's Consolidated Financial Statements in Item 1 of Part I of this report.

## FORWARD-LOOKING STATEMENTS

Certain written and oral statements made or incorporated by reference from time to time by the Company or its representatives are "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. Forward-looking statements include, without limitation, any statement that may project, indicate or imply future results, events, performance or achievements, and may contain the words "expect," "intend," "plan," "anticipate," "estimate," "believe," "will be," "will continue," "will likely result," "project," and similar expressions. Statements by the Company in this report that contain forward-looking statements include, but are not limited to, discussions regarding future market conditions and the effect of such conditions on the Company's future results of operations (see "-- Outlook"), future uses of and requirements for financial resources, including, but not limited to,

expenditures related to the deepwater upgrade of the Ocean Rover and six of the Company's jack-up rigs (see "-- Liquidity" and "-- Capital Resources")

and interest rate and foreign exchange risk (see "Quantitative and Qualitative Disclosures About Market Risk"). Such statements inherently are subject to a variety of risks and uncertainties that could cause actual results to differ materially from those projected. Such risks and uncertainties include, among others, general economic and business conditions, casualty losses, industry fleet capacity, changes in foreign and domestic oil and gas exploration and production activity, competition, changes in foreign, political, social and economic conditions, war risk, regulatory initiatives and compliance with governmental regulations, customer preferences and various other matters, many of which are beyond the Company's control. The risks included here are not exhaustive. Other sections of this report and the Company's other filings with the Securities and Exchange Commission include and describe additional factors that could adversely affect the Company's business and financial performance. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements. Each forward-looking statement speaks only as of the date of this report, and the Company expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statement to reflect any change in the Company's expectations with regard thereto or any change in events, conditions or circumstances on which any forward-looking statement is based.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

The information included in this Item is considered to constitute "forward-looking statements" for purposes of the statutory safe harbor provided in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Forward-Looking Statements" in Item 2 of Part I of this report.

#### INTEREST RATE RISK

The Company's financial instruments subject to interest rate risk include the Zero Coupon Convertible Debentures Due 2020 (the "Zero Coupon Debentures"), the 1.5% Debentures, the Ocean Alliance lease-leaseback agreement, and investments in debt securities, including U.S. Treasury and other U.S. government agency securities and collateralized mortgage obligations ("CMO's").

At June 30, 2002, the fair value of the Company's Zero Coupon Debentures, based on quoted market prices, was approximately \$426.5 million, compared to a carrying amount of \$432.1 million.

At June 30, 2002, the fair value of the Company's 1.5% Debentures, based on quoted market prices, was approximately \$421.8 million, compared to a carrying amount of \$460.0 million. At June 30, 2002, the contingent interest component of the Company's 1.5% Debentures was carried at its fair value of zero.

At June 30, 2002, the fair value of the Company's Ocean Alliance lease-leaseback agreement, based on the present value of estimated future cash flows using a discount rate of 7.27%, was approximately \$46.2 million, compared to a carrying amount of \$46.4 million.

At June 30, 2002, the fair market value of the Company's investment in debt securities issued by the U.S. Treasury and other U.S. government corporations and agencies, excluding CMO's, was approximately \$627.5 million, which includes an unrealized holding gain of \$4.8 million. The Company's investment in Treasury bills bear no interest and had an effective yield of 1.7% at June 30, 2002. The Company's investment in Treasury notes bear interest of 4.4%. These securities are U.S. government-backed, generally short-term and readily marketable.

The fair market value of the Company's investment in CMO's at June 30, 2002 was approximately \$135.4 million, which includes an unrealized holding gain of \$0.4 million. The CMO's bear interest at rates ranging from 5.3% to 5.5%. The CMO's are also short-term and readily marketable with an implied AAA rating backed by U.S. government guaranteed mortgages.

#### FOREIGN EXCHANGE RISK

In June 2002 the Company entered into foreign exchange forward contracts to purchase approximately 50.0 million Australian dollars; 4.2 million Australian dollars to be purchased monthly from August 29, 2002 through June 26, 2003 and 3.8 million to be purchased on July 31, 2003. In July 2001 the Company had contracted to purchase 3.5 million Australian dollars each month from August 31, 2001 through July 31, 2002. These foreign exchange forward contracts are recorded at their fair value determined by discounting future cash flows at current forward exchange rates. At June 30, 2002, an asset of \$0.2 million reflecting the fair value of the forward contracts, was included with "Prepaid expenses and other" in the Consolidated Balance Sheet. The associated unrealized net pre-tax gain of \$0.2 million was included in "Other income (expense)" in the Consolidated Statement of Income for the quarter ended June 30, 2002.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS.

Raymond Verdin, on behalf of himself and those similarly situated v. Pride Offshore, Inc., et al; C.A. No. G-01-168 in the United States District Court for the Southern District of Texas, Houston Division; formerly styled Raymond Verdin v. R&B Falcon Drilling USA, Inc., et al; No. G-00-488 in the United States District Court for the Southern District of Texas, Galveston Division, filed October 10, 2000. The Company was named as a defendant in a proposed class action suit filed on behalf of offshore workers against all of the major offshore drilling companies. The proposed class included persons hired in the United States by the companies to work in the Gulf of Mexico and around the world. The allegation was that the companies, through trade groups, shared information in violation of the Sherman Antitrust Act and various state laws. Plaintiff Thomas Bryant replaced the named plaintiff as the proposed class representative. The lawsuit was seeking money damages and injunctive relief as well as attorneys' fees and costs. During the first quarter of 2001, the Company recorded a \$10.0 million reserve for this pending litigation in the Company's Consolidated Statements of Income. In July 2001 the Company filed a stipulation of settlement with the District Court in which it agreed to settle the plaintiffs' outstanding claims for certain injunctive relief and a cash payment within the limits of the reserve. In April 2002 the United States District Judge for the Southern District of Texas, Houston Division, entered an order finally approving the proposed class action settlement and finally certifying the settlement class, and entered a final judgment and order of dismissal of this lawsuit. In June 2002 the Company made the final settlement payment of \$9.4 million from its reserve for this litigation.

The Company and its subsidiaries are named defendants in various lawsuits and are involved from time to time as parties to governmental proceedings, all arising in the ordinary course of business. Although the outcome of lawsuits or other proceedings involving the Company and its subsidiaries cannot be predicted with certainty and the amount of any liability that could arise with respect to such lawsuits or other proceedings cannot be predicted accurately, management does not expect these matters to have a material adverse effect on the financial position, results of operations, or cash flows of the Company.

### ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.

None.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

The Annual Meeting of Stockholders (the "Annual Meeting") of Diamond Offshore Drilling, Inc. was held on May 21, 2002 in New York, New York. At the Annual Meeting, the holders of 128,559,930 shares of common stock out of 131,553,155 shares entitled to vote as of the record date were represented in person or by proxy, constituting a quorum. The following matters were voted on and adopted by the margins indicated:

- a. To elect eight directors, each to serve until the next annual meeting of stockholders and until their respective successors are elected and qualified or until their earlier resignation or removal.

NUMBER OF  
SHARES ---

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-- BROKER  
FOR

WITHHELD  
NON-VOTE -

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James S.  
Tisch  
110,285,013  
18,274,917  
0 Lawrence

R.  
Dickerson  
110,600,943  
17,958,987  
0 Alan R.  
Batkin  
127,745,420  
814,510 0  
Herbert C.  
Hofmann  
110,286,212  
18,273,718  
0 Arthur  
L. Rebell  
110,600,848  
17,959,082  
0 William  
B.  
Richardson  
127,884,052  
675,878 0  
Michael H.  
Steinhardt  
105,354,322  
23,205,608  
0 Raymond  
S. Troubh  
127,731,065  
828,865 0

- b. To ratify the appointment of Deloitte & Touche LLP as independent certified public accountants for the Company and its subsidiaries for fiscal year 2002.

For	127,534,456
Against	992,123
Abstain	33,351
Broker Non-Vote	0

ITEM 5. OTHER INFORMATION.

On June 4, 2002 William B. Richardson became the Democratic nominee for Governor of New Mexico and effective June 30, 2002 resigned his position as a member of the Company's Board of Directors.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits

See the Exhibit Index for a list of those exhibits filed herewith.

(b) The Company filed the following reports on Form 8-K during the second quarter of 2002:

Date of Report Description of Report --- -----
----- April 18, 2002 Item 9 Regulation FD disclosure (informational only) April 25, 2002 Disclosure of the Ocean Baroness marine riser incident June 4, 2002 Item 9 Regulation FD disclosure (informational only)

SIGNATURES

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

DIAMOND OFFSHORE DRILLING, INC.  
(Registrant)

Date        13-August-2002                      By: /s/ Gary T. Krenek  
-----  
Gary T. Krenek  
Vice President and Chief Financial Officer

Date        13-August-2002                      /s/ Beth G. Gordon  
-----  
Beth G. Gordon  
Controller (Chief Accounting Officer)

EXHIBIT INDEX

EXHIBIT NUMBER DESCRIPTION ----- -----
3.1 Amended and Restated Certificate of Incorporation of the Company (incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 1998).
3.2 Amended and Restated By- laws of the Company (incorporated by reference to Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2001).