LUBRIZOL CORP
Form 10-Q
August 02, 2002

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 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 1-5263

THE LUBRIZOL CORPORATION
(Exact name of registrant as specified in its charter)

Ohio	34-0367600
(State or other jurisdiction of incorporation or organization)	(I.R.S.Employer Identification No.)

29400 Lakeland Boulevard
Wickliffe, Ohio 44092-2298
(Address of principal executive offices)
(Zip Code)

(440) 943-4200
(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 and 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 [ ]

Number of the registrant's common shares, without par value, outstanding, as of June 30, 2002: 51,438,557.

PART I. FINANCIAL INFORMATION

Item 1 Financial Statements

THE LUBRIZOL CORPORATION

CONSOLIDATED BALANCE SHEETS

(In Thousands of Dollars)	June 30 2002	December 31 2001
ASSETS		
Cash and short-term investments	$ 208,934	$ 189,095
Receivables	323,419	279,013
Inventories:		
Finished products	131,192	124,503
Products in process	62,109	48,859
Raw materials	73,486	64,504
Supplies and engine test parts	18,285	16,744
	285,072	254,610
Other current assets	39,280	34,006
Total current assets	856,705	756,724
Property and equipment - net	674,842	644,281
Goodwill and intangible assets - net	203,276	166,558
Investments in nonconsolidated companies	7,892	30,915
Other assets	69,612	63,841
TOTAL	$ 1,812,327	$ 1,662,319
LIABILITIES AND SHAREHOLDERS' EQUITY		
Short-term debt and current portion of long-term debt	$ 10,994	$ 9,120
Accounts payable	157,785	129,833
Accrued expenses and other current liabilities	132,152	120,261
Total current liabilities	300,931	259,214
Long-term debt	392,320	388,111
Postretirement health care obligation	98,002	97,878
Noncurrent liabilities	58,826	55,140
Deferred income taxes	58,157	56,207
Total liabilities	908,236	856,550
Minority interest in consolidated companies	53,501	32,577
Contingencies and commitments		
Shareholders' equity:		
Preferred stock without par value - authorized and unissued:		
Serial Preferred Stock - 2,000,000 shares		
Serial Preference Shares - 25,000,000 shares		
Common shares without par value:		
Authorized 120,000,000 shares		
Outstanding - 51,438,557 shares as of June 30, 2002 after deducting 34,757,337 treasury shares, 51,152,107 shares as of December 31, 2001 after deducting 35,043,787 treasury shares	118,301	109,692
Retained earnings	806,497	763,312

Accumulated other comprehensive loss	(74,208)	(99,812)
Total shareholders' equity	850,590	773,192
TOTAL	$ 1,812,327	$ 1,662,319

Amounts shown are unaudited.

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THE LUBRIZOL CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(In Thousands Except Per Share Data)	Second Quarter Ended June 30 2002	2001	S Period 2002
Net sales	$ 507,505	$ 485,928	$ 974,21
Royalties and other revenues	879	1,856	1,67
Total revenues	508,384	487,784	975,89
Cost of sales	361,770	350,002	692,98
Selling and administrative expenses	48,427	44,074	97,17
Research, testing and development expenses ..	41,334	38,876	81,90
Total cost and expenses	451,531	432,952	872,05
Other expense - net	(3,323)	(3,807)	(4,04
Interest income	1,500	1,293	3,20
Interest expense	(5,763)	(6,179)	(11,15
Income before income taxes and cumulative effect of change in accounting principle ...	49,267	46,139	91,86
Provision for income taxes	14,780	14,124	27,55
Income before cumulative effect of change in accounting principle	34,487	32,015	64,30
Cumulative effect of change in accounting principle	-	-	(7,78

Net income	$ 34,487	$ 32,015	$ 56,51
Net income per share:			
Income before cumulative effect of change in accounting principle	$ 0.67	$ 0.63	$ 1.2
Cumulative effect of change in accounting principle	-	-	(0.1
Net income per share	$ 0.67	$ 0.63	$ 1.1
Fully diluted net income per share:			
Income before cumulative effect of change in accounting principle	$ 0.66	$ 0.62	$ 1.2
Cumulative effect of change in accounting principle	-	-	(0.1
Net income per share, diluted	$ 0.66	$ 0.62	$ 1.0
Dividends per share	$ 0.26	$ 0.26	$ 0.5
Weighted average common shares outstanding ..	51,512	51,205	51,42

Amounts shown are unaudited.

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THE LUBRIZOL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands of Dollars)	Six Month Period Ended June 30 2002	2001
Cash provided from (used for):		
Operating activities:		
Net income	$ 56,519	$ 50,521
Adjustments to reconcile net income to cash provided		

by operating activities:		
Depreciation and amortization	46,469	49,214
Deferred income taxes	(616)	2,110
Cumulative effect of change in accounting principle	7,785	-
Change in current assets and liabilities:		
Receivables	(9,466)	(53,586)
Inventories	(164)	(5,751)
Accounts payable and accrued expenses	28,829	13,296
Other current assets	(3,294)	2,941
Other items - net	2,304	4,162
Total operating activities	128,366	62,907
Investing activities:		
Capital expenditures	(29,291)	(33,627)
Acquisitions and investments in nonconsolidated companies	(69,438)	(14,989)
Other - net	2,604	81
Total investing activities	(96,125)	(48,535)
Financing activities:		
Short-term borrowings, net of repayments	1,286	6,957
Long-term repayments	(1,128)	(2,025)
Dividends paid	(26,662)	(26,642)
Common shares purchased	-	(30,039)
Stock options exercised	7,916	14,438
Total financing activities	(18,588)	(37,311)
Effect of exchange rate changes on cash	6,186	(3,747)
Net increase (decrease) in cash and short-term investments	19,839	(26,686)
Cash and short-term investments at beginning of period	189,095	145,937
Cash and short-term investments at end of period	$ 208,934	$ 119,251

Amounts shown are unaudited.

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THE LUBRIZOL CORPORATION

Notes to Consolidated Financial Statements

Amounts in thousands (except per share data)

June 30, 2002

1. The accompanying unaudited consolidated financial statements contain all adjustments (consisting only of normal recurring accruals) necessary to present fairly the financial position as of June 30, 2002 and December 31, 2001, and the results of operations and cash flows for the applicable periods ended June 30, 2002 and 2001.

2. Net income per share is computed by dividing net income by average common

shares outstanding during the period, including contingently issuable shares. Net income per diluted share includes the dilutive effect resulting from outstanding stock options and stock awards.

Per share amounts are computed as follows:

	Second Quarter Ended June 30		Six Month Period Ended June 30	
	2002	2001	2002	2001
Numerator:				
Net income before cumulative effect of change in accounting principle	$34,487	$32,015	$ 64,304	$50,521
Cumulative effect of change in accounting principle	-	-	(7,785)	-
Net income available to common shareholders	$34,487	$32,015	$ 56,519	$50,521
Denominator:				
Weighted average common shares outstanding	51,512	51,205	51,428	51,243
Dilutive effect of stock options and awards	396	246	399	216
Denominator for net income per share, diluted	51,908	51,451	51,827	51,459
Net Income Per Share:				
Net income before cumulative effect of change in accounting principle	$ .67	$ .63	$ 1.25	$ .99
Cumulative effect of change in accounting principle	-	-	(.15)	-
Net income per share	$ .67	$ .63	$ 1.10	$ .99
Diluted Net Income Per Share:				
Net income before cumulative effect of change in accounting principle	$ .66	$ .62	$ 1.24	$ .98
Cumulative effect of change in accounting principle	-	-	(.15)	-
Net income per share, diluted	$ .66	$ .62	$ 1.09	$ .98

THE LUBRIZOL CORPORATION

Notes to Consolidated Financial Statements

Amounts in thousands (except per share data)

June 30, 2002

Weighted average shares issuable upon the exercise of stock options which were excluded from the diluted earnings per share calculations because they were antidilutive for the three- and six-month periods ended June 30, 2002 were .9 million and 1.0 million, respectively, and for the three- and six-month periods ended June 30, 2001 were 1.9 million and 2.2 million, respectively.

3. Total comprehensive income for the three- and six-month periods ended June 30, 2002 and 2001 is comprised as follows:

	Second Quarter Ended June 30		Six Month Period Ended June 30	
	2002	2001	2002	2001
Net income	$ 34,487	$ 32,015	$ 56,519	$ 50,521
Foreign currency translation adjustment	28,753	(6,746)	25,725	(20,344)
Cumulative effect of accounting change	-	-	-	(1,314)
Unrealized gains (losses) interest rate swaps	(632)	253	(121)	(356)
Total comprehensive income	$ 62,608	$ 25,522	$ 82,123	$ 28,507

4. Beginning in 2002, the company reorganized its product lines into four principal operating segments: fluid technologies for transportation, fluid technologies for industry, advanced fluid systems and emulsified products. Accordingly, the segment information for prior years has been restated to conform to the current operating structure.

Fluid technologies for transportation (FTT) is comprised of additives for lubricating engine oils, such as gasoline, diesel, marine and stationary gas engines and additive components; additives for driveline oils, such as automatic transmission fluids, gear oils and tractor lubricants; and additives for fuel products and refinery and oil field chemicals. In addition, this segment sells additive components and viscosity improvers within its lubricant and fuel additives product lines. The company's fluid technologies for transportation product lines are generally produced in shared manufacturing facilities and sold largely to a common customer base. Fluid technologies for industry (FTI) includes industrial additives, such as additives for hydraulic, grease and metalworking fluids and compressor lubricants; and performance chemicals, such as additives for coatings and inks, defoamers and process chemicals. The advanced fluid systems and emulsified products operating segments do not constitute reportable business segments. The results of these two operating segments have been aggregated into the all other segment. Advanced fluid systems is comprised of fluid metering devices, particulate emission trap devices, and FluiPak(TM) sensor systems, and emulsified products is comprised of PuriNOx(TM) low-emissions diesel fuel.

Amounts in thousands (except per share data)

The company evaluates performance and allocates resources based on segment contribution income, defined as revenues less expenses directly identifiable to the product lines aggregated within each segment.

In addition, the company allocates corporate research, testing, selling and administrative expenses, and excess production capacity costs in arriving at segment operating profit before tax. The following table presents a summary of the company's reportable segments for the three- and six-month periods ended June 30, 2002 and 2001 based on the current reporting structure.

	Second Quarter Ended June 30		Six Month P June
	2002	2001	2002
Revenues from external customers:			
FTT	$ 404,329	$ 405,779	$ 787,140
FTI	97,836	76,130	176,709
All other	6,219	5,875	12,047
Total revenues	$ 508,384	$ 487,784	$ 975,896
Segment contribution income(loss):			
FTT	$ 81,372	$ 79,536	$ 159,121
FTI	18,538	12,754	34,373
All other	(1,932)	(4,227)	(4,928)
Total segment contribution income	$ 97,978	$ 88,063	$ 188,566
Segment operating profit(loss) before tax:			
FTT	$ 42,425	$ 46,533	$ 81,717

Amounts in thousands (except per share data)

FTI	13,314	8,809	23,361
All other	(2,209)	(4,317)	(5,274)
Total segment operating profit before tax	53,530	51,025	99,804
Interest expense - net	(4,263)	(4,886)	(7,941)
Consolidated income before tax and cumulative effect of an accounting change	$ 49,267	$ 46,139	$ 91,863
Segment total assets:			
FTT	$1,159,734	$1,157,591	
FTI	289,428	211,004	
All other	22,473	34,348	
Total segment assets	$1,471,635	$1,402,943	
Corporate assets	340,692	258,672	
Total consolidated assets	$1,812,327	$1,661,615	

5. Effective January 1, 2002, the company began accounting for the investment in its India joint venture, Lubrizol India Private Limited (LIPL), through consolidation because an amendment to the joint venture agreement gave the company control as of that date. The company has ownership of 50% of the voting shares. The amended joint venture agreement grants the company the authority to appoint three of LIPL's six board directors and the unilateral and perpetual ability to appoint its managing director. Further, the amended joint venture agreement delegates to the managing director the authority to make all significant decisions to run the day-to-day business of LIPL. The company had previously accounted for its investment under the equity method of accounting because the company's joint venture partner held certain substantive participating rights, which were eliminated with the amendment to the joint venture agreement. The change to consolidate LIPL had the effect of increasing revenues and total cost and expenses by $11.8 million and $9.9 million, respectively, for the three month period ended June 30, 2002 and by $25.2 million and $22.3 million, respectively, for the six month period ended June 30, 2002. The change had no impact on net income.

6. Effective January 1, 2002, the company adopted Statement of Financial Accounting Standards (SFAS) 142, "Goodwill and Other Intangible Assets." Under SFAS 142, goodwill and other intangibles determined to have indefinite lives will no longer be amortized but will be tested for impairment upon adoption and at least annually thereafter.

Amounts in thousands (except per share data)

In connection with adopting SFAS 142, the company also reassessed the useful lives and the classification of its intangible assets. The major components of the identifiable intangible assets are technology, land use rights and trademarks. Excluding the non-amortized trademarks, which are indefinite and will not be amortized, the intangible assets will continue to be amortized over the lives of the agreements, which range between five and forty years. The following table shows the components of identifiable intangible assets as of June 30, 2002 and December 31, 2001.

	As of June 30, 2002		As of December 31,	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accu Amort
Amortized intangible assets:				
Technology	$ 30,095	$ 14,207	$ 30,095	$
Land use rights	6,990	287	6,990	
Chemron acquisition estimate	11,683	240		
Trademarks	2,211	561	2,211	
Other	2,456	1,003	2,495	
Total amortized intangible assets	53,435	16,298	41,791	
Non-amortized trademarks	21	5	21	
Total	$ 53,456	$ 16,303	$ 41,812	$

Amortization expense for intangible assets for the three- and six-month periods ended June 30, 2002 was $1.0 million and $1.8 million, respectively, and for the three- and six-month periods ended June 30, 2001 was $.8 million and $1.6 million, respectively. Amortization expense for the full year 2002 is estimated to be approximately $4.0 million, which includes an estimate for amortization expense arising from intangibles purchased in the acquisition of Kabo Unlimited, Inc. in January 2002 and Chemron Corporation in April 2002. The company is currently in the process of allocating the purchase price for both of these acquisitions, so it is possible the amount of amortization may change once the purchase price allocation is complete. Excluding the impact of further acquisitions, estimated annual intangible amortization expense for each of the next four years should approximate $4.3 million per year.

SFAS 142 provides for a six month period from the date of adoption for the company to perform an assessment of potential impairment of goodwill. Any impairment identified upon adoption is to be recognized as a cumulative effect of a change in accounting principle effective as of January 1, 2002. Goodwill is tested for impairment at the reporting unit level. The company has determined the reporting units will be the same as its four operating segments, since the component businesses have similar economic characteristics and can thus be combined under the aggregation rules. The company determined the carrying value of each operating segment by assigning the company's assets and liabilities to them, including existing goodwill, as of January 1, 2002. The company then determined the implied fair value of each operating segment by using a combination of discounted cash flow analysis and terminal value calculations. The fair value of each operating segment was compared to its carrying value to determine if there was an indication of impairment. This evaluation indicated that goodwill recorded in the advanced fluid systems operating segment was impaired as of January 1, 2002. The economic conditions at the time of impairment testing, including declining revenues, reduced the estimated future expected performance of this operating segment, which includes the small equipment businesses the company acquired in fluid metering and particulate traps. Accordingly, the company recognized a transitional impairment charge of $7.8 million retroactive to January 1, 2002 in the all other reporting segment, which includes advanced fluid systems. This is a non-cash charge and was recorded as a cumulative effect of a change in accounting principle on the Consolidated Statement of Income for the six month period ended June 30, 2002. SFAS 142 also requires goodwill to be tested annually and between annual tests if events occur or circumstances change that would more likely than not reduce the fair value of a reporting segment below its carrying amount. The company has elected to perform its annual tests for potential goodwill impairment as of October 1st of each year. Subsequent impairment losses, if any, will be reflected in income from continuing operations. The carrying amount of goodwill by reporting segment is as follows:

	FTT	FTI	All Other	Total
Balance, December 31, 2001	$ 42,755	$ 88,850	$ 7,668	$ 139,273
Goodwill acquired estimate	-	31,706	-	31,706
Transitional impairment charge	-	-	(7,785)	(7,785)
Translation & other adjustments	2,812	-	117	2,929
Balance, June 30, 2002	$ 45,567	$ 120,556	$ -	$ 166,123

Amounts in thousands (except per share data)

June 30, 2002

In accordance with SFAS 142, the company discontinued the amortization of goodwill and certain trademarks effective January 1, 2002. The following table reconciles the company's net income and earnings per share for the three- and six-month periods ended June 30, 2002 and 2001. The prior year results have been adjusted to exclude goodwill amortization expense. Current period results include an adjustment for the cumulative effect of a change in accounting principle for the transitional impairment loss under SFAS 142 and are presented for comparative purposes.

	Second Quarter Ended June 30		Six Months Ended June 30	
	2002	2001	2002	2001
Reported net income	$ 34,487	$ 32,015	$ 56,519	$ 50,521
Add: Goodwill & trademark amortization, net of tax	-	1,932	-	3,733
Cumulative effect of a change in accounting principle	-	-	7,785	-
Pro forma adjusted net income	$ 34,487	$ 33,947	$ 64,304	$ 54,254
Reported net income per share	$ .67	$ .63	$ 1.10	$ .99
Add: Goodwill & trademark amortization, net of tax	-	.04	-	.07
Cumulative effect of a change in accounting principle	-	-	.15	-
Pro forma adjusted net income per share	$ .67	$ .67	$ 1.25	$ 1.06
Reported net income per share, diluted	$ .66	$ .62	$ 1.09	$ 0.98
Add: Goodwill & trademark amortization, net of tax	-	.04	-	.07
Cumulative effect of a change in accounting principle	-	-	.15	-
Pro forma adjusted net income per share, diluted	$ 0.66	$ 0.66	$ 1.24	$ 1.05

THE LUBRIZOL CORPORATION

Notes to Consolidated Financial Statements

Amounts in thousands (except per share data)

June 30, 2002

7. In June 2001, the Financial Accounting Standards Board issued SFAS 143, "Accounting for Asset Retirement Obligations," which will become effective for the company on January 1, 2003. This statement requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. The amount recorded as a liability will be capitalized by increasing the carrying amount of the related long-lived asset. Subsequent to initial measurement, the liability is accreted to the ultimate amount anticipated to be paid and is also adjusted for revisions to the timing or amount of estimated cash flows. The capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss. The company has not determined the impact, if any, that SFAS 143 will have on its consolidated financial position or results of operations.

8. On July 24, 2002 the company terminated its interest rate swap agreements expiring December 2008, which converted fixed rate interest on $100 million of 5.875% debentures to a variable rate. In terminating the swaps, the company received cash of $18.1 million, which will be amortized as a reduction of interest expense through December 1, 2008, the due date of the underlying debt. The interest rate swaps were designated as fair value hedges under the provisions of SFAS 133, "Accounting for Derivative Instruments and Hedging Activities." Accordingly, the $14.5 million fair value of the swaps at June 30, 2002 was recorded as an increase in noncurrent assets and the carrying value of the underlying debt was adjusted by an equal amount.

THE LUBRIZOL CORPORATION

Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations

RESULTS OF OPERATIONS

We achieved record consolidated revenues in the second quarter of 2002, primarily due to higher shipment volume from the consolidation of Lubrizol India Private Limited (LIPL) and the favorable impact of acquisitions of Chemron Corporation (Chemron) and Kabo Unlimited, Inc. (Kabo). Lower average raw material cost combined with lower per-unit manufacturing cost (manufacturing costs per metric ton sold), partially offset by lower average selling price, resulted in higher gross profit margin in the second quarter of 2002 compared with the same period in 2001. The increased margin, elimination of goodwill amortization and a lower effective tax rate, partially offset by increased STAR (selling, testing, administrative and research) expenses resulted in increased net income in the second quarter of 2002 compared with the same period in 2001.

We group our product lines into three reportable segments: fluid technologies for transportation, fluid technologies for industry and all other, which is comprised of advanced fluid systems and emulsified products. Fluid technologies for transportation comprised approximately 81% of our consolidated revenues and 82% of our segment pre-tax operating profits for the first six months of 2002. This discussion and analysis of our financial condition and results of operations is primarily focused upon the company as a whole, since we believe this provides the most appropriate understanding of our business. See Note 4 to the financial statements for additional financial disclosures by reporting segment.

Our consolidated revenues increased $20.6 million, or 4%, in the second quarter of 2002 compared with the same period in 2001 and increased $33.5 million, or 4%, in the first half of 2002 compared with 2001. The primary factor causing the increase in revenues for both the 2002 second quarter and the first half of 2002 compared with the same periods in 2001 was a 9% increase in our shipment volume, partially offset by a 5% decline in average selling price. Excluding acquisitions, which include Kabo, Chemron, and the consolidation of LIPL, shipment volume increased 1% for the second quarter and 3% for the first half of 2002, compared with the same periods in 2001. Lower average selling price more than offset the higher volume, resulting in decreased revenues, excluding acquisitions and the consolidation of LIPL, of $6.3 million, or 1%, in the second quarter of 2002 and $9.6, or 1%, in the first half of 2002, compared with the same periods in the prior year.

Fluid technologies for transportation (FTT) revenues decreased $1.5 million, or less than 1%, in the second quarter of 2002 and increased $10.8 million, or 1%, in the first half of 2002, compared with the same periods in 2001. The increase in the first half of 2002 is primarily due to the consolidation of LIPL. Fluid technologies for industry (FTI) revenues increased $21.7 million, or 29%, in the second quarter of 2002 and $22.7 million, or 15%, in the first half of 2002 compared with the same periods in 2001. The increase in revenues for the FTI segment is primarily due to the Chemron and Kabo acquisitions, along with growth in the other FTI businesses. The revenues of the all other segment increased $.3 million, or 6%, in the second quarter of 2002 and were almost even in the first half of 2002, compared with the same periods in 2001.

Changes in our shipment volume vary by geographic area. The following table shows our second quarter 2002 and first half 2002 shipment volume by geographic area as well as the corresponding changes compared with same periods in 2001.

	2nd Quarter 2002 Volume	Increase (Decrease)	Year-to-date 2002 Volume	Inc (Dec
North America	46%	23%	44%	
Europe, Middle East	28%	3%	30%	
Asia-Pacific	20%	(1%)	20%	
Latin America	6%	(8%)	6%	(
Total	100%	9%	100%	

The increases in North America and Europe are due to strengthening of our business with major customer accounts and the acquisitions of Chemron and Kabo. Asia-Pacific volume increased 20% in the first quarter of 2002 but declined 1% in the second quarter of 2002, compared with the same periods in 2001, resulting in a 7% increase in the first six months of 2002 compared with the same period in 2001. Asia-Pacific volume, excluding the consolidation of LIPL, decreased 13% in the second quarter and 8% in the first half of 2002. The decline in ongoing Asian volume was primarily the result of business lost in Japan in mid-2001 and the weak business environment and competitive intensity in Asia. Latin America, our smallest zone, experienced volume declines as the result of economic conditions, timing of orders and some business losses after the first quarter of 2001 due to price increases.

Our average selling price decreased 5% in both the second quarter of 2002 and for the first half of 2002, compared with the same periods in 2001. In the second quarter of 2002, the combination of price and product mix declined 5% from the second quarter of 2001 with minimal currency effects. In the first half of 2002, the combination of price and product mix declined 4% along with 1% unfavorable currency effects, due mainly to the strength of the dollar against the euro and the yen during the first quarter of 2002. Sequentially, second quarter 2002 average selling price was 2% lower than the first quarter of 2002. The combination of price and product mix lowered selling price 3%, but was partially offset by a 1% favorable currency impact. The Chemron acquisition contributed to the sequential decrease in average selling price due to its lower priced product mix.

Royalties and other revenues decreased $1 million in both the second quarter of 2002 and the first six months of 2002, compared with the same periods in 2001. The decrease is primarily due to the consolidation of LIPL, effective January 1, 2002, as royalties from India are eliminated when reporting consolidated results. The second quarter of 2001 also included some one-time royalties.

Our cost of sales for the second quarter of 2002 increased $11.8 million, or 3% ($10.2 million, or 3%, decrease excluding acquisitions and the consolidation of LIPL), compared with the second quarter of 2001, primarily because of higher volume and a 7% increase in total manufacturing costs that was partially offset by a 7% decline in average raw material cost. Excluding acquisitions and the consolidation of LIPL, manufacturing costs were almost even with the second quarter of 2001. In the first half of 2002, our cost of sales increased $8.3 million, or 1% ($27.9 million, or 4%, decrease excluding acquisitions), compared with 2001 due to higher volume and 3% higher manufacturing costs associated with acquisitions, partially offset by an 8% decrease in average raw material cost. Excluding acquisitions and the consolidation of LIPL, manufacturing costs were down $4.9 million, or 3%, in the first half of 2002 compared with 2001. All of the decline in average raw material cost in the second quarter and most of the decline for the first half of 2002, compared with the same periods in 2001, was caused by lower raw material prices and product mix changes. The remainder of the decline for the first half of 2002 was caused by currency. Sequentially, average raw material cost continued to decline and was down 1% from the first quarter of 2002 and 7% from the fourth quarter of 2001. We expect raw material prices to increase in the third quarter, under pressure from rising crude oil prices, and estimate an increase of approximately 3% by year-end. Unit manufacturing cost was down 2% for the second quarter of 2002 and down 6% for the first half of 2002, compared with the same periods of 2001, primarily due to productivity improvements and lower utility costs.

Gross profit (net sales less cost of sales) increased $9.8 million, or 7% ($4.3 million, or 3%, excluding acquisitions and the consolidation of LIPL), in the second quarter of 2002 and increased $26.2 million, or 10% ($17.8 million, or 7%, excluding acquisitions and the consolidation of LIPL), in the first half of 2002, compared with the same periods in 2001. The increase was primarily due to the favorable impact of acquisitions, ongoing higher shipment volume, lower average raw material cost and lower unit manufacturing cost, partially offset by lower average selling price. Fluid technologies for transportation gross profit increased $4.4 million, or 4%; fluid technologies for industry gross profit increased $5.9 million, or 22%; and the all other segment gross profit increased $.7 million, or 78%, in the second quarter of 2002 compared with the second quarter of 2001. In the first half of 2002, fluid technologies for transportation gross profit increased $21.5 million, or 10%; fluid technologies for industry gross profit increased $7.4 million, or 14%; and the all other segment gross profit increased $.3 million, or 10%, compared with the first half of 2001. In calculating gross profit at the reporting segment level for internal management reporting, we exclude excess production capacity from product costs.

Our gross profit percentage (gross profit divided by net sales) increased to 28.7% in the second quarter of 2002 compared with 28.0% in the second quarter of 2001 for the reasons stated above. In the first half of 2002, our gross profit percentage increased to 28.9% compared with 27.1% in the first half of 2001. Excluding the impact of the consolidation of LIPL and acquisitions, our gross profit percentage would have been 29.2% in the second quarter of 2002 and 29.3% in the first half of 2002. Sequentially, the gross profit percentage has declined slightly from 29.0% in the first quarter of 2002.

Selling and administrative expenses increased $4.4 million, or 10% ($3.2 million or 7% excluding acquisitions and the consolidation of LIPL), for the second quarter of 2002 and increased $8.4 million, or 9% ($6.4 million, or 7%, excluding acquisitions and the consolidation of LIPL), in the first half of 2002 compared with the same periods in 2001. Excluding acquisitions, the increase for both the second quarter and first half of 2002 was primarily due to higher salary and employee benefit costs for existing businesses and incremental staffing and other costs associated with our strategy to expand into new markets. In addition, the first quarter of 2002 included a $2.0 million accrual for a contract claim related to an employee offsite personal injury.

Our research, testing and development expenses (technology expenses) increased $2.5 million, or 6% ($2.3 million, or 6%, excluding acquisitions and the consolidation of LIPL), for the second quarter of 2002 and increased $4.5 million, or 6% ($4.2 million, or 5%, excluding acquisitions and the consolidation of LIPL), in the first half of 2002 compared with the same periods in 2001. Research expenses increased because of high levels

of platform development costs for the upcoming U.S. passenger car motor oil technical standard, GF-4. This upgrade was originally slated for commercial introduction in the third quarter of 2003, but the commercial introduction is now expected to be delayed one year to late 2004. As a result, spending for GF-4 research will proceed at a slower pace during 2002 and testing will be delayed to 2003. In addition, continued testing programs for the next diesel engine oil specification, PC-9, are expected to decline, prior to formal product introduction in the third quarter of this year. We expect technology expense in the second half of 2002 to be lower than the first half.

The change in other income (expense) favorably affected pre-tax income by $.5 million in the second quarter of 2002 and by $3.8 million in the first half of 2002 compared with the same periods in 2001. Beginning in 2002, this line item no longer includes amortization of goodwill or equity income from LIPL. Goodwill amortization expense was approximately $1.9 million in the second quarter of 2001 and $3.7 million in the first half of 2001. Equity income for LIPL was $.4 million in the second quarter of 2001 and $1.1 million for the first half of 2001. The remaining variance was primarily due to unfavorable foreign exchange losses and the minority interest in our consolidated joint ventures.

Interest income increased $.2 million in the second quarter of 2002 and decreased $.1 million in the first half of 2002, compared with the same periods in 2001. Although there was a higher level of cash investments in 2002, lower interest rates contributed to the year-to-date decrease in interest income in 2002 compared with 2001. Interest expense decreased $.4 million for the second quarter of 2002 and decreased $1.6 million in the first half of 2002, compared with the same periods in 2001, also because of lower interest rates.

As a result of the above factors, our income before income taxes and before the cumulative effect of an accounting change increased 7% to $49.3 million in the second quarter of 2002 and increased 23% to $91.9 million for the first half of 2002, compared with the same periods in 2001. Segment operating profit before tax, which excludes interest expense and the cumulative effect of an accounting change, decreased for fluid technologies for transportation by $4.1 million, or 9%, for the 2002 second quarter and increased $5.3 million, or 7%, for the 2002 first half, compared with the same periods in 2001. Although segment contribution income (revenues less expenses directly identifiable to the product lines aggregated within this segment) increased 2% for this segment in the second quarter of 2002, it was more than offset by the allocation of higher corporate expenses during the comparable second quarter period. The increase in the first half of 2002 in segment operating profit before tax was due to higher shipment volume of 5%, lower average raw material cost and lower per unit manufacturing cost, partially offset by higher technical expenses.

Segment operating profit before tax for fluid technologies for industry increased $4.5 million, or 51%, in the second quarter of 2002 and $7.4 million, or 46%, in the first half of 2002, compared with the corresponding periods in

2001. The increase was due to acquisitions, growth in the ongoing business and improved cost control. The elimination of goodwill amortization, effective January 1, 2002, benefited this segment by approximately $3.1 million for the first half of 2002.

Segment operating loss before tax for the all other segment decreased $2.1 million, or 49%, in the second quarter of 2002 and $3.4 million, or 39%, in the first half of 2002, compared with the same periods in 2001, primarily due to lower levels of equity losses and the elimination of goodwill amortization in 2002.

Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations

We had an effective tax rate of 30.0% for both the second quarter and first half of 2002, compared with 30.6% and 32.1% for the corresponding periods in 2001. The lower effective tax rate in 2002 was primarily due to the U.S. tax benefit from a charitable contribution of technology made in 2002 that did not occur in 2001, along with the elimination of book goodwill amortization pursuant to the new accounting standard.

Changes in currency exchange rates during the first half of 2002 had an unfavorable effect on net income as compared with exchange rates in effect during 2001.

As a result of the factors described above, net income before the cumulative effect of an accounting change increased $2.5 million, or 8%, for the second quarter of 2002 and $13.8 million, or 27%, for the first half of 2002, compared with the same periods in 2001. Net income per share, before the cumulative effect of an accounting change, was $.67 for the second quarter and $1.25 for the first half of 2002, compared with $.63 and $.99 for the corresponding periods in 2001.

This quarter we completed the impairment analysis required for Statement of Financial Accounting Standards 142 (SFAS 142), "Goodwill and Other Intangible Assets," which we adopted on January 1, 2002. Goodwill was tested for impairment by comparing the fair value of each operating segment to its carrying value as of January 1, 2002. There was no impairment either in the fluid technologies for transportation segment or in the fluid technologies for industry operating segment. However, for the advanced fluid systems operating segment, which is included in the all other reporting segment, we recorded an impairment of $7.8 million, thus eliminating all the goodwill for the all other reporting segment. The charge was recorded as a cumulative effect of an accounting change for the first half of 2002.

After adjusting net income for the cumulative effect of an accounting change, net income for the first half of 2002 increased $6.0 million, or 12%. Net income per share was $1.10 for the first half of 2002, compared with $.99 in 2001.

WORKING CAPITAL, LIQUIDITY AND CAPITAL RESOURCES

Cash provided from operating activities was $128.4 million for the first half of 2002 as compared with $62.9 million for the first half of 2001. The increase of

$65.5 million in 2002 was primarily due to higher earnings and a $59.0 million favorable change in working capital items (current assets and liabilities) because of continued strong receivable and inventory management and favorable timing of payment of current liabilities.

Our capital expenditures in the first half of 2002 were $29.3 million, compared with $33.6 million for same period in 2001. The slower spending pattern in 2002 reflects timing of projects. We estimate capital spending for the full year 2002 to be in the range of $70 million to $75 million, compared with actual spending in 2001 of $66.3 million.

We completed an acquisition in each of the first and second quarters of 2002 for a total of $69 million. In the first quarter we purchased Kabo Unlimited, Inc., which specializes in the development, manufacture and sale of antifoam and defoaming agents to the food, fermentation, mining and wastewater industries. Kabo's product lines expand the defoamer offering and capabilities of our fluid technologies for industry segment. In the second quarter of 2002, we purchased Chemron Corporation, which formulates,

produces and supplies specialty surfactants used in personal care products, industrial cleaners and a wide range of other consumer and industrial products. The acquisition extends Lubrizol's existing surfactants business into growth markets where it does not currently compete. During 2001, the annual revenues of Kabo and Chemron were approximately $14 million and $55 million, respectively.

Our net debt to capitalization ratio at June 30, 2002 was 21%. Net debt is the total of short- and long-term debt, reduced by cash and short-term investments in excess of an assumed operating cash level of $40 million and excluding unrealized gains and losses on derivative instruments designated as fair value hedges of fixed rate debt. Capitalization is shareholders' equity plus net debt. Debt as a percent of capitalization, without adjusting for cash, was 31% at June 30, 2002.

Our share repurchase program has been suspended in the near term as we are holding our financial resources in reserve for future acquisitions. Primarily as a result of these activities and the payment of dividends, our balance of cash and short-term investments increased $19.8 million at June 30, 2002 compared with December 31, 2001.

Our financial position remains strong with a ratio of current assets to current liabilities of 2.8 to 1 at June 30, 2002, which is about equal with the ratio at December 31, 2001. Effective July 16, 2002, we renewed $175 million of committed revolving credit facilities until July 15, 2003. These credit facilities are in addition to $50 million of facilities that mature on June 30, 2003 and $350 million of facilities that mature on July 16, 2006, resulting in total credit facilities of $575 million. These facilities allow us to borrow at or below the U.S. prime rate. We believe our existing credit facilities, internally generated funds and ability to obtain additional financing, if desired, will be sufficient to meet our future capital needs, including acquisitions to expand into new and existing fluid technology markets.

THE LUBRIZOL CORPORATION

Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations

CAUTIONARY STATEMENT FOR SAFE HARBOR PURPOSES

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements within the meaning of the federal securities laws. As a general matter, forward-looking statements are those focused upon future plans, objectives or performance as opposed to historical items and include statements of anticipated events or trends and expectations and beliefs relating to matters not historical in nature. These forward-looking statements are subject to uncertainties and factors relating to our operations and business environment, all of which are difficult to predict and many of which are beyond our control. These uncertainties and factors could cause our actual results to differ materially from those matters expressed in or implied by such forward-looking statements.

We believe that the following factors, among others, could affect our future performance and cause our actual results to differ materially from those expressed or implied by forward-looking statements made in this quarterly report:

- the overall demand for lubricant and fuel additives on a worldwide basis, which has a slow growth rate in mature markets such as North America and Europe;

- the effect on our business resulting from economic and political uncertainty within the Asia-Pacific and Latin American regions;

- the lubricant additive demand in developing regions such as China and India, which geographic areas are an announced focus of our activities;

- the potential negative impact on product pricing and volume demand from the consolidation of finished lubricant marketers;

- the degree of competition resulting from lubricant additive industry over capacity;

- technology developments that affect longer-term trends for lubricant additives, such as improved equipment design, fuel economy, longer oil drain intervals, alternative fuel powered engines and emission system compatibility;

- the overall economic uncertainty and weak business environment within the global economy;

- the extent to which we are successful in expanding our business in new and existing fluid technology markets incorporating chemicals, systems and services for industry and transportation;

- our ability to identify, complete and integrate acquisitions for profitable growth;

- our success at continuing to develop proprietary technology to meet or exceed new industry performance standards and individual customer and original equipment manufacturers' expectations;

- the frequency of change in industry performance standards, which affects the level and timing of our technology costs, the product life cycles and the relative quantity of additives required for new specifications;

- our ability to continue to reduce complexities and conversion costs and modify our cost structure to maintain and enhance our competitiveness;

- our success in strengthening relationships and growing business with our largest customers, including those with affiliated lubricant additive companies, and retaining the business of our largest customers over extended time periods;

- the cost, availability and quality of raw materials, including petroleum-based products;

- the cost and availability of energy, including natural gas and electricity;

- the effects of fluctuations in currency exchange rates upon our reported results from international operations, together with non-currency risks of investing in and conducting significant operations in foreign countries, including those relating to political, social, economic and regulatory factors;

- the extent to which we achieve market acceptance of our PuriNOx(TM) low-emission, water-blend fuel product;

- significant changes in government regulations affecting environmental compliance.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We operate manufacturing and blending facilities, laboratories and offices around the world and utilize fixed and variable rate debt to finance our global operations. As a result, we are subject to business risks inherent in non-U.S. activities, including political and economic uncertainty, import and export limitations, and market risk related to changes in interest rates and foreign currency exchange rates. We believe the political and economic risks related to our foreign operations are mitigated due to the stability of the countries in which our largest foreign operations are located.

In the normal course of business, we use derivative financial instruments including interest rate swaps and foreign currency forward exchange contracts to manage our market risks. Our objective in managing our exposure to changes in interest rates is to limit the impact of such changes on earnings and cash flow and to lower our overall borrowing costs. Our objective in managing our exposure to changes in foreign currency exchange rates is to reduce volatility on our earnings and cash flow associated with such changes. Our principal currency exposures are in the major European currencies, the Japanese yen and certain Latin American currencies. We do not hold derivatives for trading purposes.

A quantitative and qualitative discussion about our market risk is contained on page 23 of our 2001 Annual Report to our shareholders. There have been no material changes in the market risks faced by us since December 31, 2001.

THE LUBRIZOL CORPORATION

PART II. OTHER INFORMATION

Item 2. Changes in Securities and Use of Proceeds

(c) On February 1, 2002 we issued 242 common shares in a private placement transaction exempt from registration under the Securities Act of 1933 pursuant to Section 4(2) of that Act. We issued the shares to the surviving spouse of a former director pursuant to a deferred compensation plan for directors.

On April 22, 2002, we issued 1,219 common shares in a private placement transaction exempt from registration under the Securities Act of 1933 pursuant to Section 4(2) of that Act. We issued the shares to a former officer pursuant to a contract and a deferred compensation plan for officers.

On May 1, 2002, we issued 622 common shares in private placement transactions exempt from registration under the Securities Act of 1933 pursuant to Section 4(2) of that Act. We issued the shares to two former directors pursuant to a deferred compensation plan for directors.

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

Our Annual Meeting of Shareholders was held April 22, 2002. The following matters were voted on by the shareholders:

1. Election of directors:

   (a) William G. Bares. The vote was 43,786,309 shares for and 370,542 shares to withhold authority.

   (b) David H. Hoag. The vote was 43,737,982 shares for and 418,868 shares to withhold authority.

   (c) Peggy Gordon Miller. The vote was 43,729,904 shares for and 426,945 shares to withhold authority.

2. A proposal to confirm the appointment of Deloitte & Touche LLP as independent auditors. The vote was 42,990,928 shares for; 1,113,686 shares against; and 52,235 abstaining.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

There are no exhibits filed for the three month period ended June 30, 2002.

(b) Reports on Form 8-K

There were no reports on Form 8-K filed during the three month period ended June 30, 2002.

THE LUBRIZOL CORPORATION

PART II. OTHER INFORMATION

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.

THE LUBRIZOL CORPORATION

/s/John R. Ahern

John R. Ahern
Chief Accounting Officer and
Duly Authorized Signatory of
The Lubrizol Corporation

Date: August 2, 2002

Certification of Chief Executive Officer and Chief Financial Officer of The Lubrizol Corporation Pursuant to 18 U.S.C. Section 1350

We certify that, to the best of our knowledge and belief, the Quarterly Report on Form 10-Q of The Lubrizol Corporation for the period ending June 30, 2002:

(1) complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

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

/s/ William G. Bares	/s/ Charles P. Cooley
William G. Bares	Charles P. Cooley
Chief Executive Officer	Chief Financial Officer
August 2, 2002	August 2, 2002