Baker Hughes-GE (BHGE)

Updated July 9th, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	$34	**5 Year CAGR Estimate:**	11.6%	**Volatility Percentile:**	92.0%
Fair Value Price:	$34	**5 Year Growth Estimate:**	1.7%	**Momentum Percentile:**	20.2%
% Fair Value:	100%	**5 Year Valuation Multiple Estimate:**	7.8%	**Valuation Percentile:**	65.7%
Dividend Yield:	2.1%	**5 Year Price Target**	$42	**Total Return Percentile:**	22.0%

Overview & Current Events

Baker Hughes, a GE company, was formed last year with the merger of Baker Hughes and General Electric Oil & Gas. The company provides integrated oilfield products, services and digital solutions and has operations in more than 120 countries. In 2017, its oilfield services division generated 47% of its total revenues while the segments of oilfield equipment, turbomachinery & process solutions and digital solutions generated 12%, 30% and 11% of its revenues, respectively.

Baker Hughes was severely affected by the downturn of the oil market that began in 2014. As the price of oil began to plunge, oil producers drastically reduced their drilling activity. Consequently, Baker Hughes incurred heavy losses in 2015 and 2016. However, thanks to the sustained efforts of OPEC and Russia, the oil market has become much tighter. Thus oil prices have enjoyed an impressive rally since last summer and are now trading at a 3.5-year high. Moreover, U.S. oil production has reached new all-time highs this year and is expected to continue to climb to new all-time highs next year. This trend certainly bodes well for the growth prospects of Baker Hughes.

In Q1, Baker Hughes reported revenues that were 9% higher than those of last year but 8% lower compared to the previous quarter. Management attributed the sequential decrease mostly to seasonal factors. Equipment orders decreased 14% while service orders fell 4%. Growth on an annual basis was witnessed in all the segments but particularly in oilfield services and turbomachinery & process solutions. Moreover, the company achieved $144 M of synergies in Q1 and is on track to generate about $700 M of synergies for the whole year.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$5.30	$1.36	$2.06	$3.97	$2.97	$2.52	$3.92	-$4.49	-$6.31	-$0.17	***$0.79***	***$2.50***
BPS	$22.03	$23.35	$32.64	$36.03	$38.71	$40.44	$42.91	$37.30	$29.85	$34.86	***$34.85***	***$38.00***
DPS	$0.56	$0.60	$0.60	$0.60	$0.60	$0.60	$0.64	$0.68	$0.68	$0.69	***$0.72***	***$0.88***

Thanks to the recovery of the oil market, Baker Hughes is expected by the analysts to post a profit of $0.79 per share this year, after three consecutive years of losses. The recovery of the company is still in its early phases due to the drastic investment cuts of all the oil producers during the recent downturn. However, as demand for oil products continues to grow at a meaningful pace amid strong global economic growth, oil producers will soon start to boost their capital expenses once again in order to outweigh the natural decline of the oil fields. As oil projects take a few years from inception until they come online, Baker Hughes is likely to enjoy a strong recovery in the upcoming years. Overall, it is reasonable to expect its earnings per share to rebound to approximately $2.50 by 2023 and its book value to rise to $38.00 thanks in part to the earnings that will be accumulated.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	12.3	27.3	22.4	16.1	15.0	19.3	16.3	N/A	N/A	N/A	***43.0***	***16.9***
Avg. P/B	1.46	1.73	1.75	1.35	1.06	1.37	1.31	1.24	2.18	0.91	***0.96***	***1.40***
Avg. Yld.	0.9%	1.6%	1.3%	0.9%	1.3%	1.2%	1.0%	1.2%	1.4%	2.0%	***2.1%***	***2.1%***

Baker Hughes is currently trading at a P/B ratio of 0.96, which is much lower than its 10-year average of 1.40. As its recovery will unwind in the next five years, the stock is likely to revert towards its average valuation level. In such a case, it will enjoy a 7.8% annualized gain thanks to the expansion of its P/B ratio.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	19.8%	33.0%	6.2%	10.5%	8.2%	7.0%	9.9%	20.7%	5.6%	14.5%	***6.1%***	***10.0%***
Debt/A	36.3%	42.6%	37.8%	35.8%	35.3%	35.9%	35.0%	32.0%	31.6%	31.3%	***74.2%***	***70.0%***
Int. Cov.	26.7	5.6	10.5	10.0	10.4	8.3	12.3	19.8	11.8	5.2	***3.5***	***10.0***
Payout	10.6%	44.1%	29.1%	15.1%	20.2%	23.8%	16.3%	N/A	N/A	N/A	***91.1%***	***35.2%***
Std. Dev.	55.3%	37.8%	39.3%	41.7%	28.2%	22.0%	32.8%	25.1%	26.6%	37.4%	***50.2%***	***35.0%***

Due to the merger of Baker Hughes with General Electric Oil & Gas, the debt-to-assets ratio has jumped from 31.3% to 74.2% while the net debt has climbed to $30.0 B. This amount of debt renders the company vulnerable to any unforeseen downturn. Just like its peers, Baker Hughes is highly cyclical and vulnerable to recessions and downturns in the oil market. The company saw its earnings per share plunge 74% in the Great Recession and incurred losses for three consecutive years during the recent downturn of the oil market.

It is remarkable that General Electric intends to sell its 62.5% stake in Baker Hughes, only a year after the merger of the two entities. While this may seem surprising on the surface, General Electric is planning to sell its stake as part of its effort to focus on its core strengths and reduce its debt. As the company will probably sell its shares over time, it is not likely to cause shocks to the stock price of Baker Hughes.

Final Thoughts & Recommendation

Due to the recent downturn of the oil market, Baker Hughes has dramatically underperformed the market in the last four years, as it has plunged 54% whereas the S&P 500 has rallied 40%. However, the company is now in the early phases of a multi-year recovery. As a result, it is likely to offer an 11.6% average annual return over the next five years thanks to 1.7% annual growth of its book value, its 2.1% dividend and a 7.8% annualized expansion of its P/B ratio.

Total Return Breakdown by Year