Baker Hughes-GE (BHGE)

Updated August 16th, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	$32	**5 Year CAGR Estimate:**	11.3%	**Volatility Percentile:**	91.5%
Fair Value Price:	$47	**5 Year Growth Estimate:**	1.7%	**Momentum Percentile:**	29.1%
% Fair Value:	68%	**5 Year Valuation Multiple Estimate:**	7.3%	**Valuation Percentile:**	94.9%
Dividend Yield:	2.3%	**5 Year Price Target**	$50	**Total Return Percentile:**	71.4%

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 the first half of this year, its oilfield services division generated 49% of its total revenues while the segments of oilfield equipment, turbomachinery & process solutions and digital solutions generated 14%, 26% and 11% of its revenues, respectively.

Baker Hughes was severely affected by the downturn of the oil market that began in 2014. During that downturn, oil producers drastically reduced their drilling activity and hence Baker Hughes incurred heavy losses in 2015 and 2016. However, thanks to the efforts of OPEC and Russia, the oil market has become much tighter and thus the price of oil has enjoyed a strong rally since last summer. 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 July, Baker Hughes reported (7/20/18) its results for the second quarter of fiscal 2018. Its orders and its revenues increased 15% and 3%, respectively, compared to prior quarter. The oilfield services segment, which generates almost half of the total sales, grew its sales by 8% vs. Q1 and by 14% vs. Q2-2017. However, the oilfield equipment and the turbomachinery & process solutions segments incurred revenue decreases and thus led the company to post adjusted EPS of just $0.10, which were below the consensus of $0.14. The company still has a long way until its earnings recover to levels seen before the downturn. On a positive note, the company achieved $189 M of synergies in Q2 and is thus 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	***$0.73***	***$2.50***
BPS	$22.03	$23.35	$32.64	$36.03	$38.71	$40.44	$42.91	$37.30	$29.85	$34.86	***$33.80***	***$37.00***
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***

As Baker Hughes disappointed the market with its Q2 results and the oil price has incurred a 10% correction in the last month, the analysts have lowered their EPS estimates from $0.79 to $0.73. 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. Overall, it is reasonable to expect its EPS to rebound to approximately $2.50 by 2023 and its book value to rise to $37.00.

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	***43.8***	***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	***0.95***	***1.35***
Avg. Yld.	0.9%	1.6%	1.3%	0.9%	1.3%	1.2%	1.0%	1.2%	1.4%	2.0%	***2.3%***	***1.7%***

Baker Hughes is currently trading at a P/B ratio of 0.95, which is much lower than its historical average of 1.35. 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 7.3% annualized gain thanks to the expansion of its P/B ratio.

Safety, Quality, Competitive Advantage, & Recession Resiliency

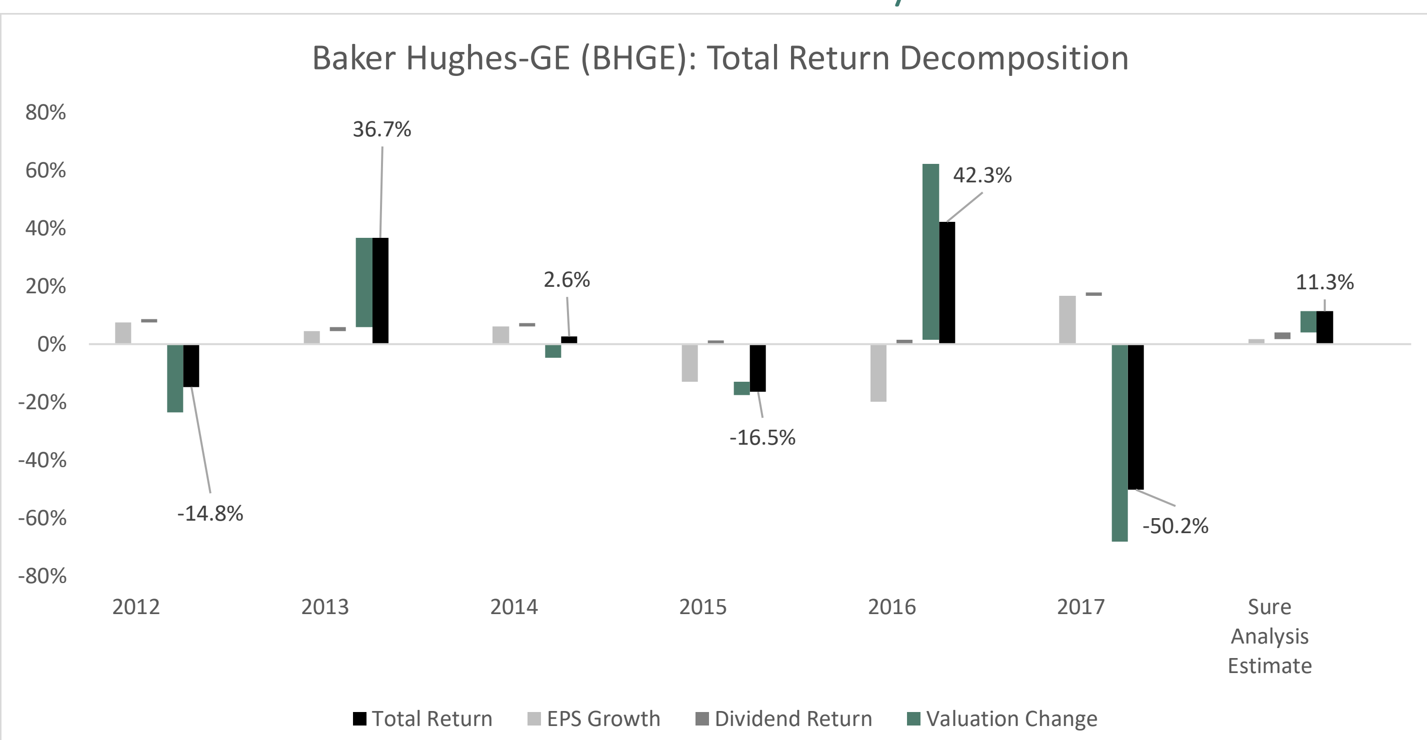
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	19.8%	33.0%	6.2%	10.5%	8.2%	7.0%	9.9%	20.7%	5.6%	14.5%	***7.0%***	***10.0%***
Debt/A	36.3%	42.6%	37.8%	35.8%	35.3%	35.9%	35.0%	32.0%	31.6%	31.3%	***74.5%***	***70.0%***
Int. Cov.	26.7	5.6	10.5	10.0	10.4	8.3	12.3	19.8	11.8	5.2	***4.1***	***10.0***
Payout	10.6%	44.1%	29.1%	15.1%	20.2%	23.8%	16.3%	N/A	N/A	N/A	***98.6%***	***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 74.5% while the net debt has climbed to $29.8 billion. 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.

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 53% whereas the S&P 500 has rallied 42%. However, the company is now in the early phases of a multi-year recovery. As a result, it is likely to offer an 11.3% average annual return over the next five years thanks to 1.7% annual growth of its book value, its 2.3% dividend and a 7.3% annualized expansion of its P/B ratio. Nevertheless, due to the high debt, the cyclicality of the stock and the elevated amount of risk that always accompanies turnarounds, we rate the stock as a "hold" and recommend it only to investors who realize its level of risk.

Total Return Breakdown by Year



Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.