Baker Hughes-GE (BHGE)

Updated October 31st, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	$27	**5 Year CAGR Estimate:**	8.9%	**Volatility Percentile:**	91.5%
Fair Value Price:	$33	**5 Year Growth Estimate:**	1.9%	**Momentum Percentile:**	18.4%
% Fair Value:	84%	**5 Year Valuation Multiple Estimate:**	4.3%	**Growth Percentile:**	4.2%
Dividend Yield:	2.7%	**5 Year Price Target**	$36.5	**Valuation Percentile:**	82.9%
Dividend Risk Score:	F	**Retirement Suitability Score:**	F	**Total Return Percentile:**	48.1%

Overview & Current Events

Baker Hughes, a GE company, was formed last year with the merger of Baker Hughes and General Electric Oil & Gas. It provides integrated oilfield products, services and digital solutions and has operations in more than 120 countries. The oilfield services currently generate 52% of total revenues while the segments of; oilfield equipment, turbomachinery & process solutions, and digital solutions generate 11%, 25%, and 12% of total revenues, respectively.

Baker Hughes was severely affected by the downturn of the oil market that began in 2014. During the 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 sanctions on Iran and supply disruptions in Libya and Venezuela, the oil market has become much tighter and the price of oil has rallied to an almost 4-year high. Moreover, U.S. oil production has reached record levels this year and is expected to continue to climb to new all-time highs next year. This trend bodes well for the growth prospects of Baker Hughes.

In late October, Baker Hughes reported (10/30/18) its financial results for the third quarter of fiscal 2018. Its revenue increased 7% over last year but its orders remained flat over last year and decreased 5% sequentially. This decrease resulted from a 47% sequential decrease in the orders of oilfield equipment. Management attributed the decrease on the timing of some deals but the magnitude of the decrease is somewhat problematic. The company missed analysts' earnings-per-share estimates ($0.19 vs. $0.21) mostly due to weakness in its turbomachinery & process solutions business but management remained optimistic about the growth prospects in the upcoming years.

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	***$0.69***	***$2.50***
BPS	$22.03	$23.35	$32.64	$36.03	$38.71	$40.44	$42.91	$37.30	$29.85	$34.86	***$33.30***	***$36.50***
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***
Shares	309.0	312.0	432.0	437.0	441.0	438.0	434.0	437.0	424.0	422.0	***410.0***	***400.0***

Due to disappointing recent earnings, we have lowered our earnings-per-share estimates for this year from $0.73 to $0.69. 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 oil fields. Overall, it is reasonable to expect earnings-per-share to rebound to approximately $2.50 by 2023 and the book value to rise to about $36.50.

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	***39.1***	***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	***0.81***	***1.00***
Avg. Yld.	0.9%	1.6%	1.3%	0.9%	1.3%	1.2%	1.0%	1.2%	1.4%	2.0%	***2.7%***	***1.7%***

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Baker Hughes is currently trading at a P/B ratio of 0.81, which is much lower than its historical average of 1.35. As the company acquired its current form only last year and is still in the early phases of its recovery, we prefer to be conservative in its valuation. We thus assume a P/B ratio of 1.0 as fair valuation. If the P/B ratio of the stock rises to 1.0, the stock will enjoy a 4.3% annualized gain thanks to the expansion of its P/B ratio.

Safety, Quality, Competitive Advantage, & Recession Resiliency

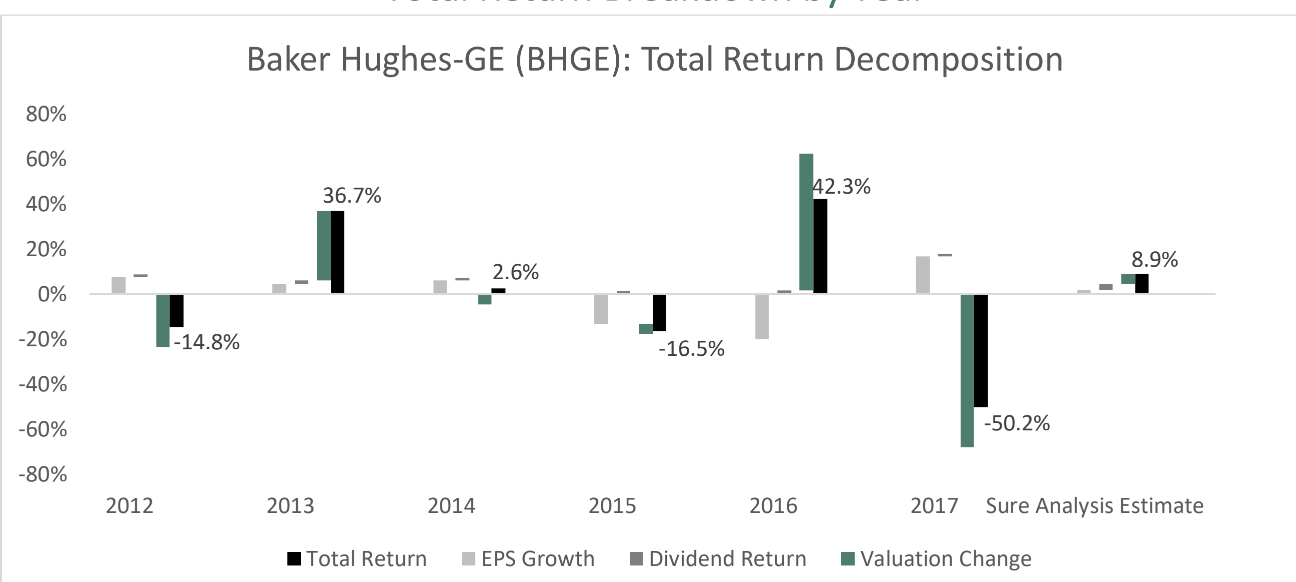
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	19.8%	33.0%	6.2%	10.5%	8.2%	7.0%	9.9%	20.7%	5.6%	14.5%	***7.0%***	***10.0%***
Debt/A	36.3%	42.6%	37.8%	35.8%	35.3%	35.9%	35.0%	32.0%	31.6%	31.3%	***74.0%***	***70.0%***
Int. Cov.	26.7	5.6	10.5	10.0	10.4	8.3	12.3	19.8	11.8	5.2	***2.0***	***8.0***
Payout	10.6%	44.1%	29.1%	15.1%	20.2%	23.8%	16.3%	N/A	N/A	N/A	***104%***	***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%. 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 in the recent downturn of the oil market. Moreover, the stock is likely to underperform during broad market corrections or bear markets. While the broad market has corrected 10% this month, Baker Hughes has lost 20%. Investors should be aware of all these risks.

Final Thoughts & Recommendation

Due to the recent downturn of the oil market, Baker Hughes has dramatically underperformed the market in the last five years, as it has plunged 53% whereas the S&P 500 has rallied 52%. However, the company is now in the early phases of a multi-year recovery and can thus offer an 8.9% average expected annual return over the next five years. 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



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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	N/A	N/A	N/A	N/A	N/A	N/A	N/A	16688	13269	17259
Gross Profit	N/A	N/A	N/A	N/A	N/A	N/A	N/A	4495	3146	3213
Gross Margin	N/A	N/A	N/A	N/A	N/A	N/A	N/A	26.9%	23.7%	18.6%
SG&A Exp.	N/A	N/A	N/A	N/A	N/A	N/A	N/A	2115	1938	2535
D&A Exp.	N/A	N/A	N/A	N/A	N/A	N/A	N/A	530	550	1103
Operating Profit	N/A	N/A	N/A	N/A	N/A	N/A	N/A	2380	1208	678
Operating Margin	N/A	N/A	N/A	N/A	N/A	N/A	N/A	14.3%	9.1%	3.9%
Net Profit	N/A	N/A	N/A	N/A	N/A	N/A	N/A	-1262	668	-73
Net Margin	N/A	N/A	N/A	N/A	N/A	N/A	N/A	-7.6%	5.0%	-0.4%
Free Cash Flow	N/A	N/A	N/A	N/A	N/A	N/A	N/A	670	-162	-1464
Income Tax	N/A	N/A	N/A	N/A	N/A	N/A	N/A	473	250	71

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	21721	57050
Cash & Equivalents	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	981	7023
Accounts Receivable	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	2091	5500
Inventories	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	3224	4590
Goodwill & Int. Ass.	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	9129	26285
Total Liabilities	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	6866	17877
Accounts Payable	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	1898	3377
Long-Term Debt	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	276	8262
Shareholder's Equity	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	14688	14709
D/E Ratio	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	0.02	0.56

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	-0.2%
Return on Equity	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	-0.5%
ROIC	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	-0.2%
Shares Out.	N/A	N/A	N/A	N/A	N/A	N/A	N/A	437.0	424.0	422.0
Revenue/Share	N/A	N/A	N/A	N/A	N/A	N/A	N/A	38.81	30.86	40.42
FCF/Share	N/A	N/A	N/A	N/A	N/A	N/A	N/A	1.56	-0.38	-3.43

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.