# Baker Hughes-GE (BHGE)

*Updated February 3rd, 2019 by Aristofanis Papadatos*

## Key Metrics

| | | | | | |
|---|---|---|---|---|---|
| **Current Price:** | $24 | **5 Year CAGR Estimate:** | 12.6% | **Volatility Percentile:** | 92.7% |
| **Fair Value Price:** | $20 | **5 Year Growth Estimate:** | 12.9% | **Momentum Percentile:** | 17.4% |
| **% Fair Value:** | 118% | **5 Year Valuation Multiple Estimate:** | -3.3% | **Growth Percentile:** | 97.0% |
| **Dividend Yield:** | 3.0% | **5 Year Price Target** | $37 | **Valuation Percentile:** | 19.9% |
| **Dividend Risk Score:** | F | **Retirement Suitability Score:** | D | **Total Return Percentile:** | 70.0% |

## Overview & Current Events

Baker Hughes, a GE company, was formed in 2017 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 segment currently generate 48% of total revenues while the segments of; oilfield equipment, turbomachinery & process solutions, and digital solutions generate 13%, 28%, and 11% of total revenues, respectively.

In November, General Electric, the major shareholder of Baker Hughes, reduced its stake in the company from 62.5% to 50.4% in an attempt to raise cash and fund its excessive debt obligations.

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, the oil price has doubled off its bottom in early 2016. In addition, U.S. oil production reached record levels last year and is expected by EIA to climb to new all-time highs this year, above 12.0 million barrels per day. Thanks to the recovery of the oil price and the growth of global oil production, particularly in the U.S., the business of Baker Hughes is in recovery mode.

In late January, Baker Hughes reported (1/31/19) its financial results for the fourth quarter of fiscal 2018. In the quarter, its revenue increased 11% sequentially and 8% over last year. Its orders jumped 20% sequentially and thus reached an almost 3-year high thanks to growth in all the business segments. In the year, Baker Hughes switched from losses to profits for the first time in four years. It also achieved $800 million of synergies and posted free cash flows of $1.2 billion. Overall, it was a strong report, which confirmed the ongoing recovery of the company. The only negative aspect is the collapse of the oil price since early October, which is likely to weigh on the results of the company in the first half of this year.

## Growth on a Per-Share Basis

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **EPS** | $1.36 | $2.06 | $3.97 | $2.97 | $2.52 | $3.92 | -$4.49 | -$6.31 | -$0.17 | $0.65 | ***$1.20*** | ***$2.20*** |
| **DPS** | $0.60 | $0.60 | $0.60 | $0.60 | $0.60 | $0.64 | $0.68 | $0.68 | $0.69 | $0.72 | ***$0.72*** | ***$0.88*** |
| **Shares** | 312.0 | 432.0 | 437.0 | 441.0 | 438.0 | 434.0 | 437.0 | 424.0 | 422.0 | 463.0 | ***463.0*** | ***450.0*** |

The recovery of Baker Hughes is still in its early phases due to the drastic investment cuts of all the oil producers during the recent downturn. However, the booming U.S. oil production and the growing global oil production, which is required to satisfy the growing demand for oil products, have already begun to benefit Baker Hughes and will continue to provide a tailwind to its business results in the upcoming years.

Overall, it is reasonable to expect earnings-per-share to rebound to approximately $2.20 by 2024. We have lowered our long-term forecast from $2.50 to $2.20 only to be more conservative amid the dramatic swings of the oil price and some concerns over global economic deceleration.

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## Valuation Analysis

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | Now | 2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Avg. P/E** | 27.3 | 22.4 | 16.1 | 15.0 | 19.3 | 16.3 | N/A | N/A | N/A | 47.4 | ***20.0*** | ***16.9*** |
| **Avg. Yld.** | 1.6% | 1.3% | 0.9% | 1.3% | 1.2% | 1.0% | 1.2% | 1.4% | 2.0% | 2.3% | ***3.0%*** | ***2.4%*** |

Excluding the years in which depressed earnings resulted in abnormally high price-to-earnings ratios, Baker Hughes has traded at an average price-to-earnings ratio of 16.9 during the last decade. The stock is currently trading at an earnings multiple of 20.0. As the recovery of its business unwinds over the next five years, Baker Hughes is likely to revert to its average valuation level during this period. If this occurs, the stock will incur a 3.3% annualized drag in its returns.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

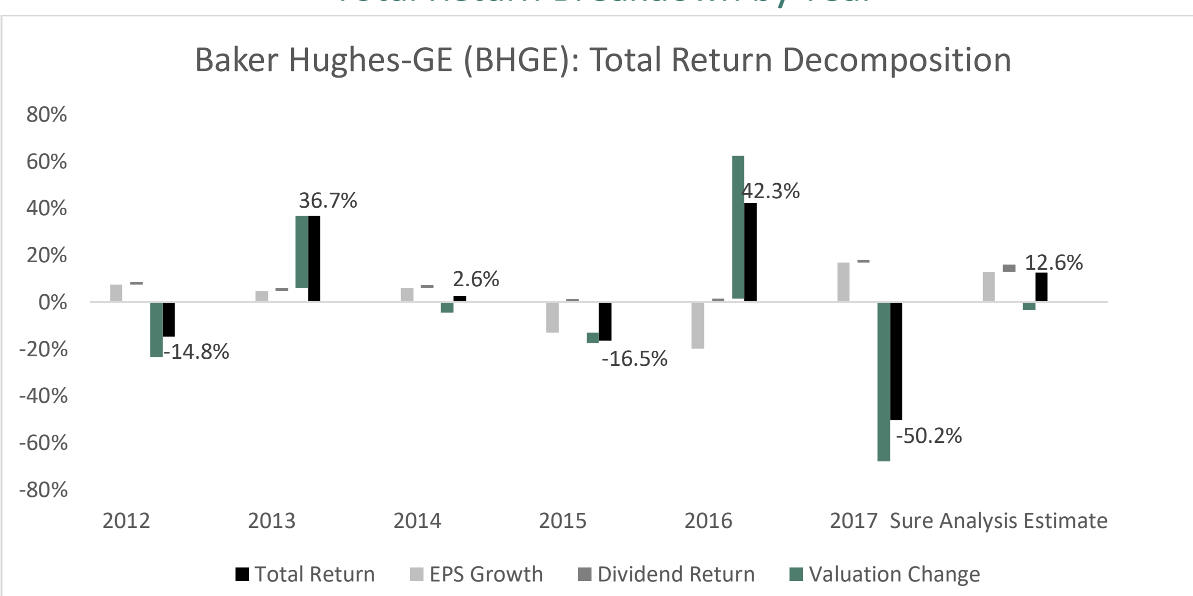
| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Payout** | 44.1% | 29.1% | 15.1% | 20.2% | 23.8% | 16.3% | N/A | N/A | N/A | 111% | ***60.0%*** | ***40.0%*** |

While Baker Hughes has great expertise in oilfield services, it lacks a durable competitive advantage. 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 during corrections or bear markets. In the last six months, Baker Hughes has lost 28% whereas S&P has shed only 5%. Investors should be aware of these risks.

## Final Thoughts & Recommendation

Due to the downturn of the oil market, Baker Hughes has dramatically underperformed the market in the last five years, as it has plunged 59% whereas the S&P 500 has rallied 50%. However, the company is now in the early phases of a multi-year recovery and can thus offer a 12.6% average 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 are comfortable with the elevated risks here.

## Total Return Breakdown by Year

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*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.*

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## Income Statement Metrics

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|---|---|---|---|
| Revenue | N/A | N/A | N/A | N/A | N/A | N/A | 16688 | 13269 | 17259 | 22877 |
| Gross Profit | N/A | N/A | N/A | N/A | N/A | N/A | 4495 | 3146 | 3213 | 3986 |
| Gross Margin | N/A | N/A | N/A | N/A | N/A | N/A | 26.9% | 23.7% | 18.6% | 17.4% |
| SG&A Exp. | N/A | N/A | N/A | N/A | N/A | N/A | 2115 | 1938 | 2535 | 2699 |
| D&A Exp. | N/A | N/A | N/A | N/A | N/A | N/A | 530 | 550 | 1103 | 1486 |
| Operating Profit | N/A | N/A | N/A | N/A | N/A | N/A | 2380 | 1208 | 678 | 1287 |
| Operating Margin | N/A | N/A | N/A | N/A | N/A | N/A | 14.3% | 9.1% | 3.9% | 5.6% |
| Net Profit | N/A | N/A | N/A | N/A | N/A | N/A | -1262 | 668 | -73 | 195 |
| Net Margin | N/A | N/A | N/A | N/A | N/A | N/A | -7.6% | 5.0% | -0.4% | 0.9% |
| Free Cash Flow | N/A | N/A | N/A | N/A | N/A | N/A | 670 | -162 | -1464 | 767 |
| Income Tax | N/A | N/A | N/A | N/A | N/A | N/A | 473 | 250 | 71 | 258 |

## Balance Sheet Metrics

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|---|---|---|---|
| Total Assets | N/A | N/A | N/A | N/A | N/A | N/A | N/A | 21721 | 57050 | 52439 |
| Cash & Equivalents | N/A | N/A | N/A | N/A | N/A | N/A | N/A | 981 | 7023 | 3723 |
| Accounts Receivable | N/A | N/A | N/A | N/A | N/A | N/A | N/A | 2091 | 5500 | 5969 |
| Inventories | N/A | N/A | N/A | N/A | N/A | N/A | N/A | 3224 | 4590 | 4620 |
| Goodwill & Int. Ass. | N/A | N/A | N/A | N/A | N/A | N/A | N/A | 9129 | 26285 | 26436 |
| Total Liabilities | N/A | N/A | N/A | N/A | N/A | N/A | N/A | 6866 | 17877 | 17426 |
| Accounts Payable | N/A | N/A | N/A | N/A | N/A | N/A | N/A | 1898 | 3377 | 4025 |
| Long-Term Debt | N/A | N/A | N/A | N/A | N/A | N/A | N/A | 276 | 8262 | 7227 |
| Shareholder's Equity | N/A | N/A | N/A | N/A | N/A | N/A | N/A | 14688 | 14709 | N/A |
| D/E Ratio | N/A | N/A | N/A | N/A | N/A | N/A | N/A | 0.02 | 0.56 | N/A |

## Profitability & Per Share Metrics

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|---|---|---|---|
| Return on Assets | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | -0.2% | 0.4% |
| Return on Equity | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | -0.5% | N/A |
| ROIC | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | -0.2% | N/A |
| Shares Out. | 312.0 | 432.0 | 437.0 | 441.0 | 438.0 | 434.0 | 437.0 | 424.0 | 422.0 | 463.0 |
| Revenue/Share | N/A | N/A | N/A | N/A | N/A | N/A | 38.81 | 30.86 | 40.42 | 20.80 |
| FCF/Share | N/A | N/A | N/A | N/A | N/A | N/A | 1.56 | -0.38 | -3.43 | 0.70 |

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