Baker Hughes (BKR)

Updated November 13th, 2019 by Aristofanis Papadatos

Key Metrics

Current Price:	$22	**5 Year CAGR Estimate:**	10.2%	**Volatility Percentile:**	93.9%
Fair Value Price:	$15	**5 Year Growth Estimate:**	16.4%	**Momentum Percentile:**	24.5%
% Fair Value:	148%	**5 Year Valuation Multiple Estimate:**	-7.5%	**Growth Percentile:**	98.8%
Dividend Yield:	3.3%	**5 Year Price Target**	$32	**Valuation Percentile:**	13.1%
Dividend Risk Score:	F	**Retirement Suitability Score:**	F	**Total Return Percentile:**	82.1%

Overview & Current Events

Baker Hughes has operations in more than 120 countries, a market capitalization of $23 billion and provides integrated oilfield products, services and digital solutions. On October 17th, 2019, Baker Hughes, a GE company with ticker BHGE, changed its name to Baker Hughes, which has BKR as a ticker. The change of the name followed the reduction of the stake of General Electric in the company below 50% (to 36.8%). The oilfield services segment generates 54% of total revenues while the segments of oilfield equipment, turbomachinery & process solutions, and digital solutions generate 12%, 23%, and 11% 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, the oil price has doubled off its bottom in early 2016. Moreover, U.S. oil production has kept posting new all-time highs in recent years and is expected by EIA to keep climbing to new all-time highs in the years ahead. Thanks to the recovery of the oil price and the growth of global oil production, the business of Baker Hughes is in recovery mode.

In late October, Baker Hughes reported (10/30/19) financial results for the third quarter of fiscal 2019. Its orders of $7.8 billion increased 19% sequentially and 35% over last year's quarter while its revenue of $5.9 billion fell -2% sequentially but rose 4% over last year's quarter. Moreover, the company grew its adjusted earnings-per-share from $0.20 in the second quarter to $0.21 thanks to strong performance in Turbomachinery and Oilfield Equipment. However, adjusted earnings-per-share missed analysts' consensus by $0.03 and free cash flow plunged sequentially from $355 million to $161 million. Due to the disappointing results and the continuing budget tightening of North American oil producers, we have lowered our earnings-per-share forecast for the year from $1.00 to $0.89.

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	***$0.89***	***$1.90***
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[1]	312.0	432.0	437.0	441.0	438.0	434.0	437.0	424.0	422.0	463.0	***541.0***	***550.0***

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. The booming U.S. oil production and the growing global oil production, which is required to satisfy the growing demand for oil products, will provide a tailwind to its business results in the upcoming years. Moreover, a major growth driver will be the increasing demand from LNG projects. Nevertheless, major technological advances have made it possible to produce more oil with fewer operating rigs. In essence, providers of oilfield services and equipment have been victims of their own success. This helps explain the markedly weak recovery of the results of Baker Hughes amid all-time high global and U.S. oil production. Due to the poor recovery of Baker Hughes, we have lowered our forecast for the earnings-per-share in 2024 from $2.20 to $1.90.

[1] In millions.

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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	---	---	---	47.4	***24.7***	***16.7***
Avg. Yld.	1.6%	1.3%	0.9%	1.3%	1.2%	1.0%	1.2%	1.4%	2.0%	2.3%	***3.3%***	***2.8%***

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 16.7 during the last decade. The stock is currently trading at an earnings multiple of 24.7. As the recovery of its business unwinds over the next five years, Baker Hughes may revert to its average valuation level during this period. If this occurs, the stock will incur a -7.5% annualized drag in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

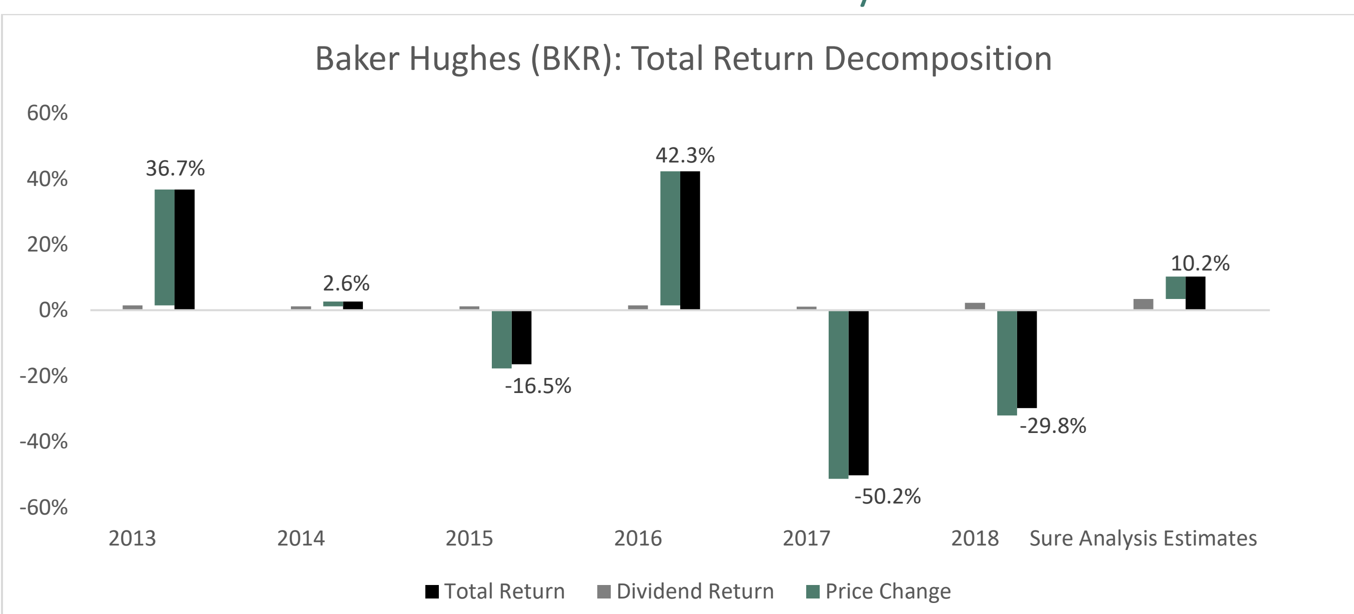
Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	44.1%	29.1%	15.1%	20.2%	23.8%	16.3%	---	---	---	111%	***80.9%***	***46.1%***

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 energy sector. Moreover, the stock is likely to underperform during broad market corrections or bear markets. Investors should be aware of these risks.

Final Thoughts & Recommendation

Due to the prolonged downturn in its business, Baker Hughes has dramatically underperformed the market in the last five years, as it has lost -67% whereas the S&P has rallied 49%. However, the company is now in the early phases of a multi-year recovery and could offer a 10.2% 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," as it is only suitable for investors who are comfortable with the elevated risks.

Total Return Breakdown by Year



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Income Statement Metrics

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

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	---	---	---	---	---	---	---	21721	57050	52439
Cash & Equivalents	---	---	---	---	---	---	---	981	7023	3723
Accounts Receivable	---	---	---	---	---	---	---	2091	5500	5969
Inventories	---	---	---	---	---	---	---	3224	4590	4620
Goodwill & Int. Ass.	---	---	---	---	---	---	---	9129	26285	26436
Total Liabilities	---	---	---	---	---	---	---	6866	17877	17426
Accounts Payable	---	---	---	---	---	---	---	1898	3377	4025
Long-Term Debt	---	---	---	---	---	---	---	276	8262	7227
Shareholder's Equity	---	---	---	---	---	---	---	14688	14709	N/A
D/E Ratio	---	---	---	---	---	---	---	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	-0.2%	0.4%
Return on Equity	---	---	---	---	---	---	---	N/A	-0.5%	N/A
ROIC	---	---	---	---	---	---	---	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	---	---	---	---	---	---	38.81	30.86	40.42	20.80
FCF/Share	---	---	---	---	---	---	1.56	-0.38	-3.43	0.70

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

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