Baker Hughes (BKR)

Updated January 22nd, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	$23	**5 Year CAGR Estimate:**	9.3%	**Market Cap:**	$23.4 B
Fair Value Price:	$22	**5 Year Growth Estimate:**	8.0%	**Ex-Dividend Date:**	2/3/20[1]
% Fair Value:	106%	**5 Year Valuation Multiple Estimate:**	-1.1%	**Dividend Payment Date:**	2/17/20[1]
Dividend Yield:	3.1%	**5 Year Price Target**	$32	**Years Of Dividend Growth:**	0
Dividend Risk Score:	F	**Retirement Suitability Score:**	F	**Last Dividend Increase:**	N/A

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%). In 2019, the oilfield services segment generated 54% of total revenues while the segments of oilfield equipment, turbomachinery & process solutions, and digital solutions generated 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 for many more years. Thanks to the recovery of oil prices and the growth of global oil production, the business of Baker Hughes is in recovery mode.

In late January, Baker Hughes reported (1/22/20) financial results for the fourth quarter of fiscal 2019. Its orders of $6.9 billion decreased -11% sequentially due to a -31% decline in orders in turbomachinery & process solutions. On the other hand, revenue of $6.3 billion grew 8% sequentially and adjusted earnings-per-share rose from $0.21 to $0.27 thanks to 36% revenue growth in turbomachinery & process solutions. Despite the decent revenue and earnings growth, the market focused on the disappointing orders in the turbomachinery & process solutions, which resulted from poor demand from LNG projects and does not bode well for the future results of this segment, which is viewed as a major growth driver. As a result, the stock remained flat after the earnings release.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$2.06	$3.97	$2.97	$2.52	$3.92	-$4.49	-$6.31	-$0.17	$0.65	$0.85	***$1.30***	***$1.91***
DPS	$0.60	$0.60	$0.60	$0.60	$0.64	$0.68	$0.68	$0.69	$0.72	$0.72	***$0.72***	***$0.88***
Shares[2]	432.0	437.0	441.0	438.0	434.0	437.0	424.0	422.0	463.0	653.0	***653.0***	***650.0***

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 probably 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. Overall, we expect the company to grow its earnings-per-share at an 8.0% average annual rate over the next five years.

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[1] Estimated date

[2] In millions.

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	22.4	16.1	15.0	19.3	16.3	---	---	---	47.4	28.1	***17.7***	***16.7***
Avg. Yld.	1.3%	0.9%	1.3%	1.2%	1.0%	1.2%	1.4%	2.0%	2.3%	3.0%	***3.1%***	***2.7%***

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 17.7. 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 -1.1% annualized drag in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

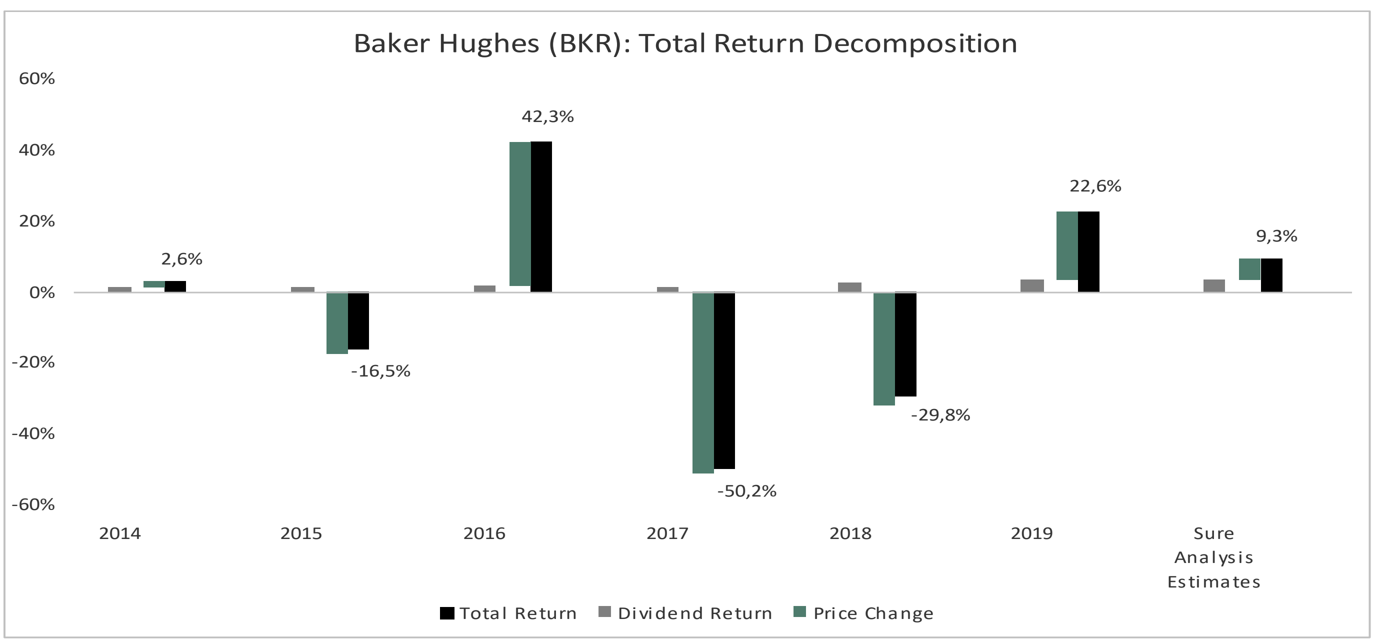
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	29.1%	15.1%	20.2%	23.8%	16.3%	---	---	---	111%	84.7%	***55.4%***	***45.9%***

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 -61% whereas the S&P has rallied 67%. However, the company is now in the early phases of a multi-year recovery and could offer a 9.3% 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
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.	432.0	437.0	441.0	438.0	434.0	437.0	424.0	422.0	463.0	653.0
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.