Baker Hughes (BKR)

Updated May 11th, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	$15	**5 Year CAGR Estimate:**	10.5%	**Market Cap:**	$15.5 B
Fair Value Price:	$13	**5 Year Growth Estimate:**	11.0%	**Ex-Dividend Date:**	5/18/20[1]
% Fair Value:	120%	**5 Year Valuation Multiple Estimate:**	-3.5%	**Dividend Payment Date:**	5/29/20[1]
Dividend Yield:	4.8%	**5 Year Price Target**	$21	**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 $15.5 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 is currently facing a fierce downturn due to the spread of the coronavirus, which has caused a collapse in the global demand for oil products. As a result, global drilling activity is likely to remain suppressed in the near future. To provide a perspective, the number of U.S. active drilling rigs has decreased for seven consecutive weeks at a fast clip and has slumped to an 11-year low level.

In late April, Baker Hughes reported (4/22/20) financial results for the first quarter of fiscal 2020. Its orders of $5.5 billion decreased -20% sequentially while its revenue of $5.4 billion fell -15% sequentially due to a collapse in the price of oil. Adjusted earnings-per-share plunged -59% sequentially, from $0.27 to $0.11, in line with expectations. Notably, the company wrote off $16.3 billion of assets due to the collapse of the oil price. While the market tends to overlook one-time write-offs, this amount raises a red flag, as it is greater than the current market cap of the stock. Due to the pandemic, we now expect Baker Hughes to earn only $0.20 per share this year.

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	***$0.20***	***$1.26***
DPS	$0.60	$0.60	$0.60	$0.60	$0.64	$0.68	$0.68	$0.69	$0.72	$0.72	***$0.72***	***$0.72***
Shares[2]	432.0	437.0	441.0	438.0	434.0	437.0	424.0	422.0	463.0	653.0	***654.0***	***650.0***

The recovery of Baker Hughes was lackluster even before the current downturn. 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. However, we expect the pandemic to subside and the energy market to recover from next year. The return of the U.S. and global oil production to their long-term growth trajectories would provide a tailwind to the business results of Baker Hughes in the upcoming years. Moreover, a major growth driver could be the increasing demand from LNG projects. In order to calculate the expected return of Baker Hughes, we have used its 2-year average earnings-per-share of $0.75 as a base, as we view this level as an appropriate mid-cycle level. We expect the company to grow its earnings-per-share at an 11.0% average annual rate over the next five years off its mid-cycle level.

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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	***20.0***	***16.7***
Avg. Yld.	1.3%	0.9%	1.3%	1.2%	1.0%	1.2%	1.4%	2.0%	2.3%	3.0%	***4.8%***	***3.4%***

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 16.7 during the last decade. The stock is currently trading at 20.0 times its mid-cycle earnings. As its business recovers over the next five years, Baker Hughes could revert to its average valuation level during this period. If this occurs, the stock will incur a -3.5% annualized drag in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

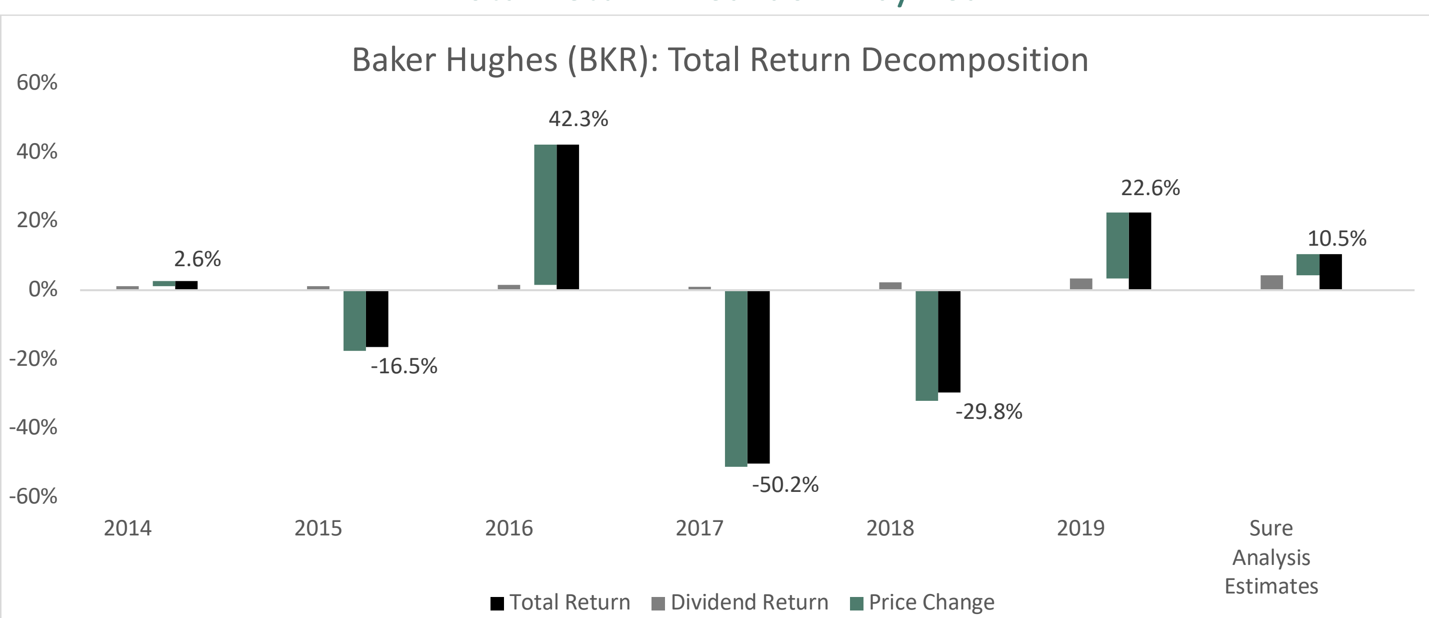
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	29.1%	15.1%	20.2%	23.8%	16.3%	---	---	---	111%	84.7%	***96.0%***	***57.0%***

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 energy sector (2015-2017). It is also vulnerable in the ongoing downturn, partly due to its high net debt of $10.1 billion. Moreover, the stock tends 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 46%. We expect the energy market to recover from the pandemic by next year and thus we expect Baker Hughes to offer a 10.5% 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, particularly if the ongoing downturn lasts longer than expected, we rate the stock as a hold.

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	23,838
Gross Profit	---	---	---	---	---	4495	3146	3213	3986	4,432
Gross Margin	---	---	---	---	---	26.9%	23.7%	18.6%	17.4%	18.6%
SG&A Exp.	---	---	---	---	---	2115	1938	2535	2699	2,832
D&A Exp.	---	---	---	---	---	530	550	1103	1486	1,418
Operating Profit	---	---	---	---	---	2380	1208	678	1287	1,600
Operating Margin	---	---	---	---	---	14.3%	9.1%	3.9%	5.6%	6.7%
Net Profit	---	---	---	---	---	-1262	668	-73	195	128
Net Margin	---	---	---	---	---	-7.6%	5.0%	-0.4%	0.9%	0.5%
Free Cash Flow	---	---	---	---	---	670	-162	-1464	767	886
Income Tax	---	---	---	---	---	473	250	71	258	482

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	---	---	---	---	---	---	21,721	56,500	52,439	53,369
Cash & Equivalents	---	---	---	---	---	---	981	7,030	3,723	3,249
Accounts Receivable	---	---	---	---	---	---	1,699	4,700	4,974	5,448
Inventories	---	---	---	---	---	---	3,224	4,507	4,620	4,608
Goodwill & Int. Ass.	---	---	---	---	---	---	9,129	26,285	26,436	26,071
Total Liabilities	---	---	---	---	---	---	6,866	18,090	17,426	18,870
Accounts Payable	---	---	---	---	---	---	1,898	3,377	4,025	4,268
Long-Term Debt	---	---	---	---	---	---	276	8,262	7,227	6,622
Shareholder's Equity	---	---	---	---	---	---	14,688	14,277	17,465	21,929
D/E Ratio	---	---	---	---	---	---	0.02	0.58	0.41	0.30

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	---	---	---	---	---	---	---	-0.2%	0.4%	0.2%
Return on Equity	---	---	---	---	---	---	---	-0.4%	1.2%	0.6%
ROIC	---	---	---	---	---	---	---	-0.2%	0.4%	0.3%
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	30.42	40.23	53.33	42.80
FCF/Share	---	---	---	---	---	1.56	(0.38)	(3.43)	1.79	1.59

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