# Baker Hughes (BKR)

*Updated August 14th, 2020 by Aristofanis Papadatos*

## Key Metrics

| | | | | | |
|---|---|---|---|---|---|
| **Current Price:** | $17 | **5 Year CAGR Estimate:** | 7.8% | **Market Cap:** | $18.2 B |
| **Fair Value Price:** | $13 | **5 Year Growth Estimate:** | 11.0% | **Ex-Dividend Date:** | 8/7/20 |
| **% Fair Value:** | 136% | **5 Year Valuation Multiple Estimate:** | -5.9% | **Dividend Payment Date:** | 8/21/20 |
| **Dividend Yield:** | 4.2% | **5 Year Price Target** | $21 | **Years Of Dividend Growth:** | 0 |
| **Dividend Risk Score:** | F | **Retirement Suitability Score:** | D | **Last Dividend Increase:** | N/A |

## Overview & Current Events

Baker Hughes has operations in more than 120 countries, a market capitalization of $18.2 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%). On July 29th, 2020, General Electric announced that it will sell its whole stake in Baker Hughes over the next three years in order to reduce its debt load. In 2019, the oilfield services segment of Baker Hughes generated 54% of its 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 pandemic, which has caused a collapse in global drilling activity. To provide a perspective, the average number of U.S. active drilling rigs in June plunged 72% Y/Y, from 969 to 274, and thus it is now hovering around an 11-year low level. The Canadian rig count plunged 84% Y/Y in June.

In late July, Baker Hughes reported (7/22/20) financial results for the second quarter of fiscal 2020. The suppressed oil and gas prices caused a sharp decline in drilling activity. As a result, orders of $4.9 billion decreased -12% sequentially (on top of a -20% decrease in the first quarter) while revenue of $4.7 billion fell -13% sequentially. The company thus switched from an adjusted profit of $0.11 per share in the first quarter to an adjusted loss of -$0.05 per share.

The majority of lockdowns worldwide have eased in the third quarter but the demand for refined products remains well below last year's levels, especially the demand for jet fuel, which has collapsed due to the plunge in global air traffic. We continue to expect poor results from Baker Hughes this year and a gradual recovery from next 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[1]** | 432.0 | 437.0 | 441.0 | 438.0 | 434.0 | 437.0 | 424.0 | 422.0 | 463.0 | 653.0 | ***655.0*** | ***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.

[1] In millions.

*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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## 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 | ***22.7*** | ***16.7*** |
| Avg. Yld. | 1.3% | 0.9% | 1.3% | 1.2% | 1.0% | 1.2% | 1.4% | 2.0% | 2.3% | 3.0% | ***4.2%*** | ***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 22.7 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 would incur a -5.9% annualized drag in its returns.

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

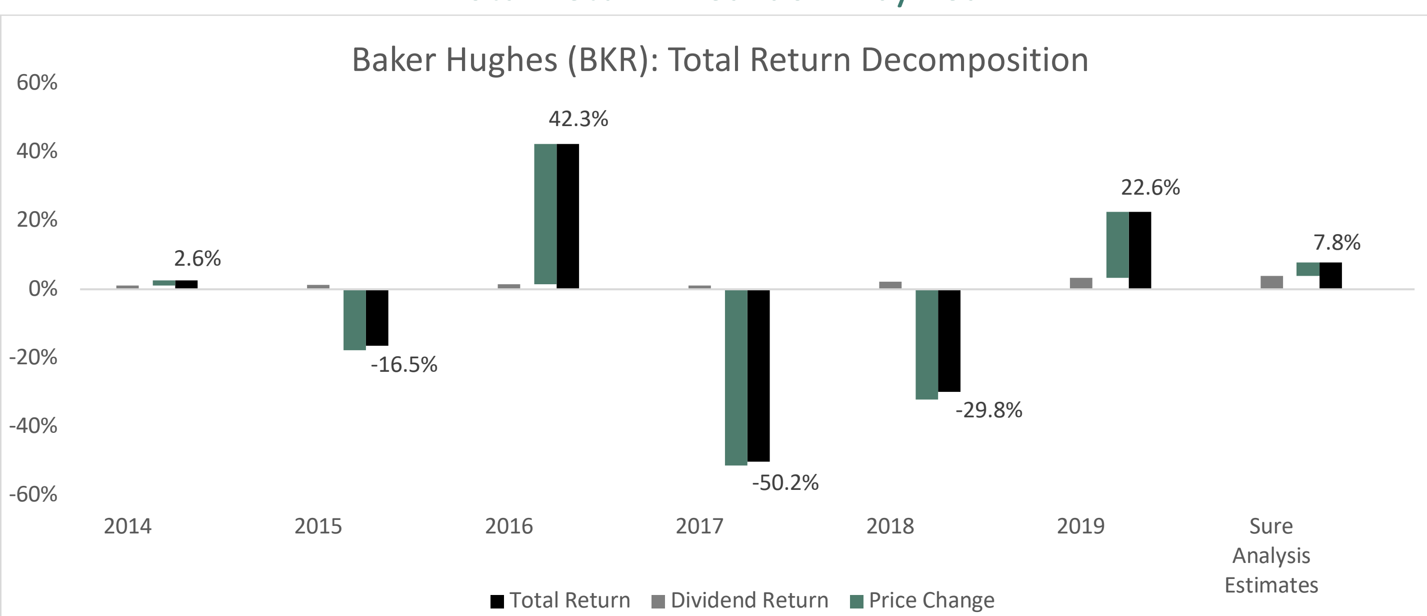
| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2025 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Payout | 29.1% | 15.1% | 20.2% | 23.8% | 16.3% | --- | --- | --- | 111% | 84.7% | ***96.0%*** | ***57.0%*** |

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 -70% whereas the S&P has rallied 61%. We expect the energy market to recover from the pandemic by next year and thus we expect Baker Hughes to offer a 7.8% 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.*