Baker Hughes (BKR)

Updated April 23rd, 2021 by Aristofanis Papadatos

Key Metrics

Current Price:	$20	**5 Year CAGR Estimate:**	5.9%	**Market Cap:**	$20.6 B
Fair Value Price:	$13	**5 Year Growth Estimate:**	13.0%	**Ex-Dividend Date:**	5/21/21[1]
% Fair Value:	160%	**5 Year Valuation Multiple Estimate:**	-8.9%	**Dividend Payment Date:**	6/4/21
Dividend Yield:	3.6%	**5 Year Price Target**	$23	**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 $20.6 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 2020, the oilfield services segment of Baker Hughes generated 49% of its total revenues while the segments of oilfield equipment, turbomachinery & process solutions, and digital solutions generated 14%, 28%, and 9% of total revenues, respectively.

In late April, Baker Hughes reported (4/21/21) financial results for the first quarter of fiscal 2021. The pandemic continued to weigh on the drilling activity. As a result, orders of $4.5 billion decreased -18% Y/Y while revenue of $4.8 billion fell -12% Y/Y. The company marginally improved its adjusted earnings-per-share from $0.11 in the prior year's quarter to $0.12. Notably Baker Hughes performed worse than its peer Halliburton for a second consecutive quarter, as the latter improved its revenue sequentially. However, we expect a recovery for Baker Hughes in the upcoming quarters.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	$3.97	$2.97	$2.52	$3.92	-$4.49	-$6.31	-$0.17	$0.65	$0.85	$0.03	***$0.75***	***$1.38***
DPS	$0.60	$0.60	$0.60	$0.64	$0.68	$0.68	$0.69	$0.72	$0.72	$0.72	***$0.72***	***$0.72***
Shares[2]	437.0	441.0	438.0	434.0	437.0	424.0	422.0	463.0	653.0	713.0	***750.0***	***800.0***

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 in 2018-2019. However, we expect the pandemic to subside and the energy market to recover in the second half of this year. The return of the U.S. and global oil production to their long-term growth trajectories will 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. Overall, we expect Baker Hughes to grow its earnings-per-share at a 13.0% average annual rate over the next five years off this year's low comparison base. On the other hand, we do not like the extremely volatile and unreliable performance record of the company.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	16.1	15.0	19.3	16.3	---	---	---	47.4	28.1	---	***26.7***	***16.7***
Avg. Yld.	0.9%	1.3%	1.2%	1.0%	1.2%	1.4%	2.0%	2.3%	3.0%	4.3%	***3.6%***	***3.1%***

[1] Estimated date.
[2] In millions.
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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 26.7 times its expected earnings this year. 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 an -8.9% annualized drag in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

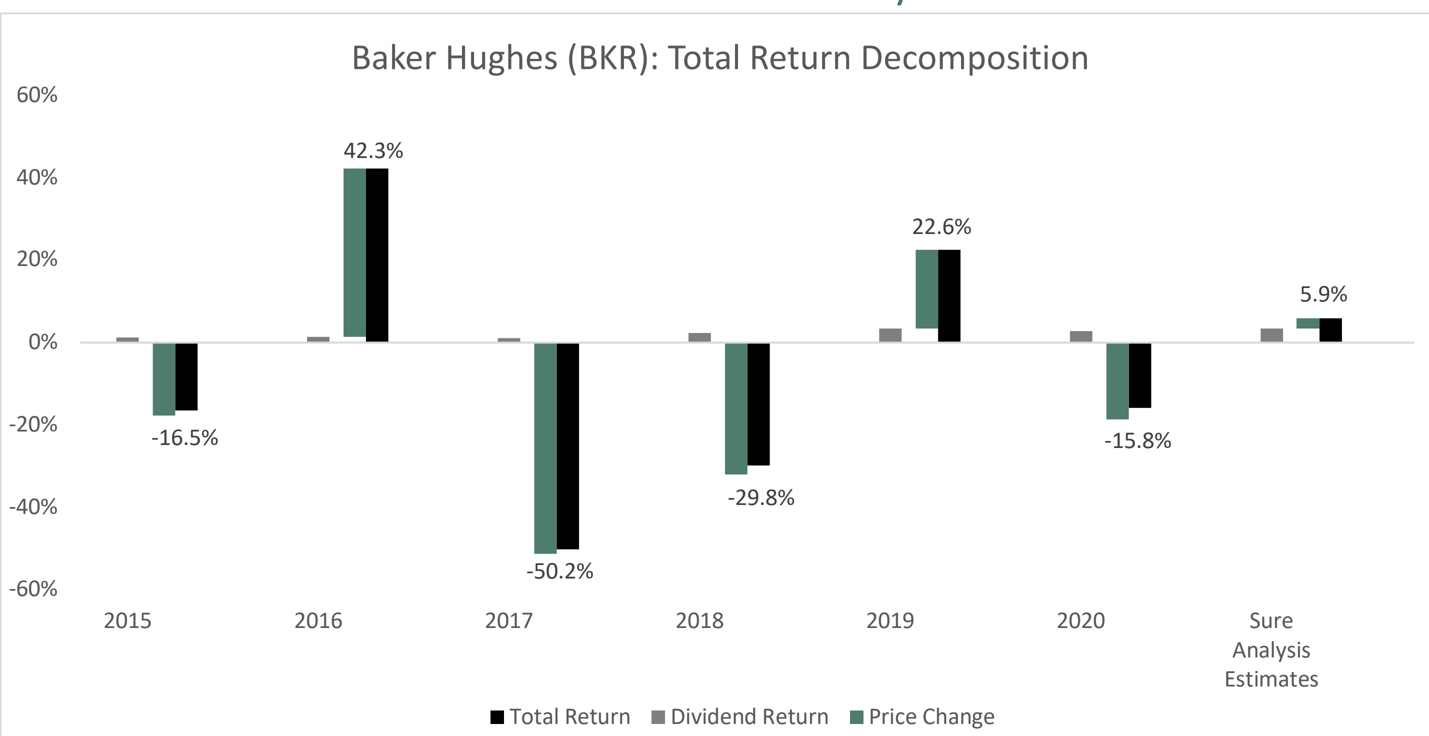
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	15.1%	20.2%	23.8%	16.3%	---	---	---	111%	84.7%	---	***96.0%***	***52.1%***

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 hefty 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 $9.8 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 -57% whereas the S&P has rallied 97%. We expect the energy market to recover from the pandemic late this year but the market has already priced a significant portion of the recovery in the stock of Baker Hughes. We thus expect Baker Hughes to offer a 5.9% average annual return over the next five years and hence we rate the stock as a hold. Moreover, investors should be aware of the high debt, the cyclicality of the stock and the elevated amount of risk, particularly if the ongoing downturn lasts longer than expected.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	---	---	---	---	16688	13269	17259	22877	23,838	20,705
Gross Profit	---	---	---	---	4495	3146	3213	3986	4,432	3,199
Gross Margin	---	---	---	---	26.9%	23.7%	18.6%	17.4%	18.6%	15.5%
SG&A Exp.	---	---	---	---	2115	1938	2535	2699	2,832	2,404
D&A Exp.	---	---	---	---	530	550	1103	1486	1,418	1,317
Operating Profit	---	---	---	---	2380	1208	678	1287	1,600	795
Operating Margin	---	---	---	---	14.3%	9.1%	3.9%	5.6%	6.7%	3.8%
Net Profit	---	---	---	---	-1262	668	-73	195	128	-9,940
Net Margin	---	---	---	---	-7.6%	5.0%	-0.4%	0.9%	0.5%	-48.0%
Free Cash Flow	---	---	---	---	670	-162	-1464	767	886	517
Income Tax	---	---	---	---	473	250	71	258	482	559

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	---	---	---	---	---	21,721	56,500	52,439	53,369	38,030
Cash & Equivalents	---	---	---	---	---	981	7,030	3,723	3,249	4,132
Accounts Receivable	---	---	---	---	---	1,699	4,700	4,974	5,448	5,622
Inventories	---	---	---	---	---	3,224	4,507	4,620	4,608	4,421
Goodwill & Int. Ass.	---	---	---	---	---	9,129	26,285	26,436	26,071	10,374
Total Liabilities	---	---	---	---	---	6,866	18,090	17,426	18,870	19,788
Accounts Payable	---	---	---	---	---	1,898	3,377	4,025	4,268	3,532
Long-Term Debt	---	---	---	---	---	276	8,262	7,227	6,622	7,633
Shareholder's Equity	---	---	---	---	---	14,688	14,277	17,465	21,929	18,242
D/E Ratio	---	---	---	---	---	0.02	0.58	0.41	0.30	0.42

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	---	---	---	---	---	---	-0.2%	0.4%	0.2%	-21.8%
Return on Equity	---	---	---	---	---	---	-0.4%	1.2%	0.6%	-49.5%
ROIC	---	---	---	---	---	---	-0.2%	0.4%	0.3%	-29.7%
Shares Out.	437.0	441.0	438.0	434.0	437.0	424.0	422.0	463.0	653.0	713.0
Revenue/Share	---	---	---	---	38.81	30.42	40.23	53.33	42.80	30.67
FCF/Share	---	---	---	---	1.56	(0.38)	(3.43)	1.79	1.59	0.77

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