



Research Analysts:

Konrad Piszczatowski (konrad.piszczatowski@uconn.edu)

Jose Netto (jose.netto@uconn.edu)

Recommendation: **BUY**

UConn Student Managed Fund

Baker Hughes Company (NYSE: BKR)

November 18, 2020

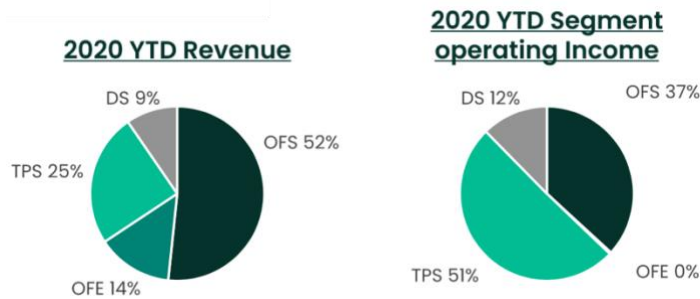
Target Price: \$22.79
Current Price: \$18.04
Stop loss: \$13.53
52 Week High/Low: \$25.99/\$9.19

Market Cap (\$B): \$13.7
Dividend Yield: 4.03%
Beta: 1.37

P/E Ratio (TTM): 49.7
EV/EBITDA: 8.5
EBITDA Margin: 11%
Gross Margin: 17%

Company Overview

Baker Hughes Company provides a portfolio of technologies and services worldwide. The company operates through four segments: Oilfield Services (OFS), Oilfield Equipment (OFE), Turbomachinery & Process Solutions (TPS), and Digital Solutions (DS).



Industry Outlook

The Energy Equipment & Services Industry in the Energy Sector includes Oil and Gas Drilling contractors, or owners of drilling rigs that contract their services for drilling wells. It also includes manufacturers of Oil and Gas equipment (including drilling rigs and equipment), and providers of supplies and services to companies involved in drilling, evaluation, and completion of oil and gas wells.

The sector has been negatively affected by COVID-19 shutdowns and lower demand for oil and gas. Upstream players have been quick to halt drilling in response to the Covid-19 outbreak, with rig count hitting historic lows. Positive results of vaccine efficacy signal a turn-around in the sector.

Investment Thesis

A.I. Integration – Baker Hughes is well positioned to benefit from emerging demand in Artificial Intelligence (AI) based solutions as part of customers’ digital transformation initiatives.

Diversified portfolio of products and services – Baker Hughes has a global presence with a diversified portfolio. Products and services range from upstream, midstream/LNG, downstream and broader chemical and industrial segments.

Transition of energy – Ability to reduce customer’s carbon footprint with a range of emissions-reducing products with more efficient power generation and compression technology. As well as a range of inspection and sensor technology that can monitor and help reduce flaring and emission.

Technology – Differentiated technology to improve efficiency and productivity gains for customers. Committed to investing in products and services to maintain leadership position across offerings. Continuing R&D resulted in 2,700 patents granted in 2019.

Investment Risks

Oil price volatility- OPEC+ price wars can have a negative impact in oil prices and production, lowering orders and services provided by Baker Hughes. Additionally, lower energy demand from epidemic related shutdown can continue to impact oil prices.

FX Risk- Approximately 70% of Baker Hughes revenues comes from outside of the United States. Such high exposure to international markets and related currency risk could negative impact cash flows.

Political Risk- Geopolitical uncertainty and civil unrest in areas that Baker Hughes operates could impact their business and investments. Changes in tax laws, tax rates and tariffs could impact operating results.



Financial Performance

(In millions, except per share amounts)	Year Ended December 31,		
	2019	2018	2017
Revenue:			
Sales of goods	\$ 13,689	\$ 13,113	\$ 11,062
Sales of services	10,149	9,764	6,117
Total revenue	23,838	22,877	17,179
Costs and expenses:			
Cost of goods sold	11,798	11,524	9,486
Cost of services sold	7,608	7,367	4,657
Selling, general and administrative	2,832	2,699	2,535
Restructuring, impairment and other	342	433	412
Separation and merger related	184	153	373
Total costs and expenses	22,764	22,176	17,463
Operating income (loss)	1,074	701	(284)
Other non operating income (loss), net	(84)	202	80
Interest expense, net	(237)	(223)	(131)
Income (loss) before income taxes and equity in loss of affiliate	753	680	(335)
Equity in loss of affiliate	—	(139)	(11)
Provision for income taxes	(482)	(258)	(45)
Net income (loss)	271	283	(391)
Less: Net income attributable to GE O&G pre-merger	—	—	42
Less: Net income (loss) attributable to noncontrolling interests	143	88	(330)
Net income (loss) attributable to Baker Hughes Company	\$ 128	\$ 195	\$ (103)

(In millions, except par value)	December 31,	
	2019	2018
ASSETS		
Current Assets:		
Cash and cash equivalents ⁽¹⁾	\$ 3,249	\$ 3,723
Current receivables, net	6,416	5,969
Inventories, net	4,608	4,620
All other current assets	949	659
Total current assets	15,222	14,971
Property, plant and equipment, less accumulated depreciation	6,240	6,228
Goodwill	20,690	20,717
Other intangible assets, net	5,381	5,719
Contract and other deferred assets	1,881	1,894
All other assets	3,001	1,838
Deferred income taxes	954	1,072
Total assets ⁽¹⁾	\$ 53,369	\$ 52,439
LIABILITIES AND EQUITY		
Current Liabilities:		
Accounts payable	\$ 4,268	\$ 4,025
Short-term debt and current portion of long-term debt ⁽¹⁾	321	942
Progress collections and deferred income	2,870	1,765
All other current liabilities	2,555	2,288
Total current liabilities	10,014	9,020
Long-term debt	6,301	6,285
Deferred income taxes	51	143
Liabilities for pensions and other employee benefits	1,079	1,018
All other liabilities	1,425	960
Equity:		
Class A common stock, \$0.0001 par value - 2,000 authorized, 650 and 513 issued and outstanding as of December 31, 2019 and 2018, respectively	—	—
Class B common stock, \$0.0001 par value - 1,250 authorized, 377 and 522 issued and outstanding as of December 31, 2019 and 2018, respectively	—	—
Capital in excess of par value	23,565	18,659
Retained earnings (loss)	—	25
Accumulated other comprehensive loss	(1,636)	(1,219)
Baker Hughes Company equity	21,929	17,465
Noncontrolling interests	12,570	17,548
Total equity	34,499	35,013
Total liabilities and equity	\$ 53,369	\$ 52,439

Valuation Assumptions & Key Financials

We recommend a BUY rate for Baker Hughes based on a target price of \$22.79 per share. This target price reflects a 27.55% margin of safety based on its closing price of \$17.87 on November 13th, 2020. We calculated WACC as 6.42%, assuming a terminal growth rate of 2% and 8x exit EV/EBITDA. We used the Perpetuity Growth and terminal EV/EBITDA method to calculate the final target price of \$22.79.

Scenario	Perpetuity	EBITDA	Weights	Value	2016	2017	2018	2019	2020E	2021E	2022E	2023E	2024E	2025E
Bull	23.43	24.88	15%	24.30	13,082.00	17,179.00	22,877.00	23,838.00	20,500.68	20,705.69	21,884.22	23,229.27	24,691.88	25,513.48
Base	22.20	23.58	50%	23.03	%YoY Growth	31.32%	33.17%	4.20%	-14.00%	1.00%	5.69%	6.15%	6.30%	3.33%
Bear	21.02	22.33	35%	21.81	EBITDA	1,604.00	2,773.00	3,018.00	2,497.89	2,425.62	2,585.24	2,610.39	2,655.65	2,747.46
					% Margin	9.34%	12.12%	12.66%	12.18%	11.71%	11.81%	11.24%	10.76%	10.77%
					Free Cash Flow	(2,362.00)	2,101.00	1,104.00	844.78	869.65	926.74	871.52	869.29	895.70
					% Margin	-13.75%	9.18%	4.63%	4.12%	4.20%	4.23%	3.75%	3.52%	3.51%



Target Price	22.79
Current Share Price	17.87
MOS	27.55%

WACC	Terminal Growth				
	1.00%	1.50%	2.00%	2.50%	3.00%
22.20					
7.50%	\$ 14.08	\$ 15.33	\$ 16.81	\$ 18.59	\$ 20.76
7.00%	\$ 15.69	\$ 17.20	\$ 19.01	\$ 21.22	\$ 23.99
6.50%	\$ 17.59	\$ 19.43	\$ 21.69	\$ 24.51	\$ 28.14
6.00%	\$ 19.87	\$ 22.17	\$ 25.04	\$ 28.74	\$ 33.66
5.50%	\$ 22.66	\$ 25.59	\$ 29.35	\$ 34.37	\$ 41.40

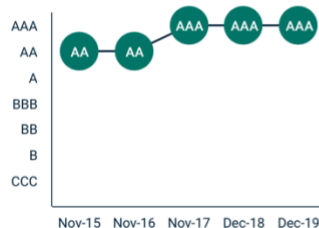
WACC	EBITDA Multiple			
	4	6	8	10
23.58				
7.50%	\$ 11.10	\$ 16.68	\$ 22.27	\$ 27.85
7.00%	\$ 11.44	\$ 17.15	\$ 22.86	\$ 28.57
6.50%	\$ 11.78	\$ 17.63	\$ 23.47	\$ 29.32
6.00%	\$ 12.13	\$ 18.12	\$ 24.11	\$ 30.09
5.50%	\$ 12.49	\$ 18.62	\$ 24.75	\$ 30.88

ESG Considerations

Baker Hughes is the leader of the energy equipment & services industry with a MSCI AAA rating. According to MSCI, Baker Hughes is an ESG leader in Biodiversity & land use, carbon emissions, health & safety, toxic emissions & waste, and average in corporate governance and corporate behavior. Baker Hughes has taken additional steps to improve compliance with an updated their code of conduct and continuing extensive training. Regarding the environment, Baker Hughes plans to be net-zero CO2 equivalent by 2050, a develop products and services to help the industry lower its carbon footprint.

ESG Rating history

MSCI ESG Rating history data over the last five years or since records began.



ESG Rating distribution

Universe: MSCI ACWI Index constituents energy equipment & services, n=9.

