

Baker Hughes

1Q18 First Take - ALERT

Neutral

BHGE, BHGE US

Price: \$33.71

19 Apr 2018

- **EPS Results.** Operating EPS \$0.09 v. JPMe \$0.10 and consensus \$0.06.
- **Our Take.** As we expect to be a theme for large cap service prints, we think Baker Hughes' 1Q18 results are fairly innocuous for the stock following a [walk-down of Street expectations](#) earlier in the quarter. The quarter matched JPMe on revenue and EBITDA with the operating beat driven by lower D&A. The company highlighted some nice contract/share wins (e.g. wireline and drilling in GOM, subsea/EPCI, chems, lift) that should offer fodder for BHGE's conference call (and others'). FCF in 1Q should be welcomed by shareholders, though capex was extremely light and WC still a use of cash (not a surprise for 1Q); we think FCF trajectory remains critical to show solid dividend coverage. With a lower bar than peers to bridge the gap to 2Q (+13% q/q to Street EBITDA), the stock is well positioned to outperform modestly barring any surprises on the call, particularly around TPS expectations. TPS remains a blind spot for most investors in our view, and expectations vary widely as a result. They want the coming LNG cycle (and impact to BHGE) better framed out.
- **Operating Details.** Baker Hughes' operating EPS of \$0.09 and adjusted EBITDA of \$616mm (-13% q/q) effectively matched our numbers on in-line revenue (-7% q/q, -1% v. JPMe) and margin (-80bps q/q, +5bps v. JPMe) aided by lower D&A (worth ~3% to EBITDA). Results exclude \$269mm (\$0.08/sh) of charges mostly related to \$162mm of restructuring and \$61mm of inventory write-down. Segment margin results were mostly consistent with expectations, with OFS margin posting slightly better (+135bps v. JPMe, +160bps q/q) and Digital modestly worse (-105bps v. JPMe, -425bps q/q). Total orders of \$5.2bn declined 8% q/q (+2% v. JPMe, 0.97x book:bill), while FCF came in better attributable roughly evenly to lower capex and cash restructuring.
- **Segment Results.** Turbomachinery: EBIT of \$119mm (36% mix) mostly matched our estimate despite a revenue shortfall (-12% q/q, -6% v. JPMe) as margin came in ~60bps higher relative to JPMe. Orders of \$1.45bn (0.99x book:bill) declined 16% q/q as strength in equipment new units was offset by lower contractual services volume. Oilfield Services: EBIT of \$141mm bested our estimate (+38% q/q, +37% v. JPMe) on modestly higher revenue (+3% v. JPMe) as improved product mix, synergies and lower D&A drove margins higher (+133bps v. JPMe). NAM revenue was flat q/q while international decreased 6%. Oilfield Equipment: EBIT of -\$6mm remained in negative territory on flattish revenue (+2% q/q, +8% v. JPMe) and a 36bp decremental. Orders of \$499mm (0.75x book:bill) came in ~3% lower q/q, but in line with JPMe, as equipment dropped 5% y/y while services gained 18%. Digital Solutions: EBIT of \$73mm fell 38% q/q (-14% v. JPMe) on weaker top line (-17% q/q, -7% v. JPMe) and margin compression (-425bps q/q) due to seasonality. Orders declined 6% q/q (1.09x book:bill, -4% v. JPMe).

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- **Balance Sheet & Cash Flow.** BHGE generated \$226mm of cash in 1Q (v. \$3mm JPMe), including ~\$100mm related to restructuring and merger-related payments. Working capital was a ~\$75mm drag, and capex of \$70mm was ~70% light v. JPMe. During 1Q, Baker repurchased ~\$500mm of common stock (~\$187mm class A shares, ~\$313mm class B), and the company ended the quarter with net debt of ~\$1.8bn including ~\$5.6bn in cash.
- **Key Questions.** (1) TPS: What drove the softer margin results v. preliminary expectations? How much of a drag were program cost investments, and what is the timing/magnitude of anticipated benefits? (2) OFS: Pricing trends across product lines or geographies? Any update on international sales channel optimization initiatives? (3) Cash flow: How did working capital metrics track relative to expectations, and is WC expected to be a net source of cash through 3Q (excluding 4Q seasonal inflows)? Any target on timing or earnings run-rate needed to reach “normalized” FCF/NI conversion goals?
- **Dial-in Details.** April 20 at 9:30am ET. Webcast link [here](#)

Table 1: Baker Hughes Quarterly Earnings: Actuals v. JPMe

Revenue Breakdown	Mix	1Q18a	1Q18e	vs. JPMe	4Q17	q/q	1Q17	y/y
Turbomachinery and Process Solutio	27%	1,460	1,561	-6%	1,651	-12%	1,644	-11%
Oilfield Services	50%	2,678	2,610	3%	2,781	-4%	2,390	12%
Oilfield Equipment	12%	664	616	8%	650	2%	716	-7%
Digital Solutions	11%	598	641	-7%	717	-17%	573	4%
Eliminations	0%	0	0	-	0	-	0	-
Total Revenue	100%	\$5,400	\$5,428	-1%	\$5,799	-7%	\$5,323	1%

Operating Income Breakdown	Mix	1Q18a	1Q18e	vs. JPMe	4Q17	q/q	1Q17	y/y
Turbomachinery and Process Solutio	36%	119	118	1%	157	-24%	252	-53%
Oilfield Services	43%	141	103	37%	102	38%	76	86%
Oilfield Equipment	-2%	(6)	(4)	36%	(1)	500%	50	-112%
Digital Solutions	22%	73	85	-14%	118	-38%	63	16%
Segment Operating Income	100%	\$327	\$301	9%	\$376	-13%	\$441	-26%
Corporate		(99)	(92)	7%	(92)	8%	(158)	-37%
Merger, Restructuring, Impairment & Other		(269)	(300)	-10%	(395)	-32%	(244)	10%
Total Adjusted Operating Income		\$228	\$209	9%	\$284	-20%	\$283	-19%

Total D&A (incl. in COGS & SG&A)	(388)	(407)	-5%	(425)	-9%	
EBITDA	616	616	0%	709	-13%	
<i>Margin</i>	11.4%	11.3%	6 bps	12.2%	-82 bps	
Net Financial Expense	(46)	(60)	-23%	(56)	-18%	
Equity Income (Loss)	2	16	-87%	13	-85%	
Income Before Taxes	184	165	12%	241	-24%	
Income Taxes	(62)	(58)	8%	(94)	-34%	
<i>Tax Rate</i>	34%	35%		39.0%		
Net Income	38	40	-5%	46	-17%	
EPS (Adjusted, diluted)	\$0.09	\$0.10	-6%	\$0.11	-16%	
<i>Diluted Shares (Avg)</i>	422	420	1%	427	-1%	

Operating Income Margins	1Q18a	1Q18e	vs. JPMe	4Q17	q/q	1Q17	y/y
Turbomachinery and Process Solutions	8.2%	7.5%	62 bps	9.5%	-136 bps	15.3%	-718 bps
Oilfield Services	5.3%	3.9%	133 bps	3.7%	160 bps	3.2%	209 bps
Oilfield Equipment	-0.9%	-0.7%	-19 bps	-0.2%	-75 bps	7.0%	-789 bps
Digital Solutions	12.2%	13.2%	-104 bps	16.5%	-425 bps	11.0%	121 bps
Segment Operating Margin	6.1%	5.5%	51 bps	6.5%	-43 bps	8.3%	-223 bps
Total Adjusted Operating Income	4.2%	3.8%	38 bps	4.9%	-68 bps	5.3%	-109 bps

Incr/Decremental EBIT Margins	Q-Qa	Q-Qe	vs. JPMe	Y-Ya	Y-Ye	vs. JPMe
Turbomachinery and Process Solutions	20%	44%	-24%	72%	162%	-90%
Oilfield Services	-38%	0%	-37%	23%	12%	10%
Oilfield Equipment	-36%	10%	-46%	108%	54%	53%
Digital Solutions	38%	43%	-6%	40%	32%	8%
Total Operating Income	14%	20%	-6%	-71%	-71%	0%

Orders Summary	1Q18a	1Q18e	vs. JPMe	4Q17	q/q	1Q17	y/y
Turbomachinery and Process Solutions	1,450	1,327	9%	1,728	-16%	1,314	10%
Oilfield Services	2,640	2,610	1%	2,765	-5%	2,397	10%
Oilfield Equipment	499	493	1%	515	-3%	476	5%
Digital Solutions	649	673	-4%	694	-6%	631	3%
Total Orders	5,238	5,102	3%	5,702	-8%	4,818	9%

Balance Sheet & Cash Flow Metrics	1Q18a	1Q18e	vs. JPMe
Cash from Operations	294	220	34%
Capex	(69)	(217)	-68%
Free Cash Flow	226	3	7433%
Net Debt	1,841	2,441	-25%

Source: Company reports and J.P. Morgan estimates. Note: \$ in millions except where noted.

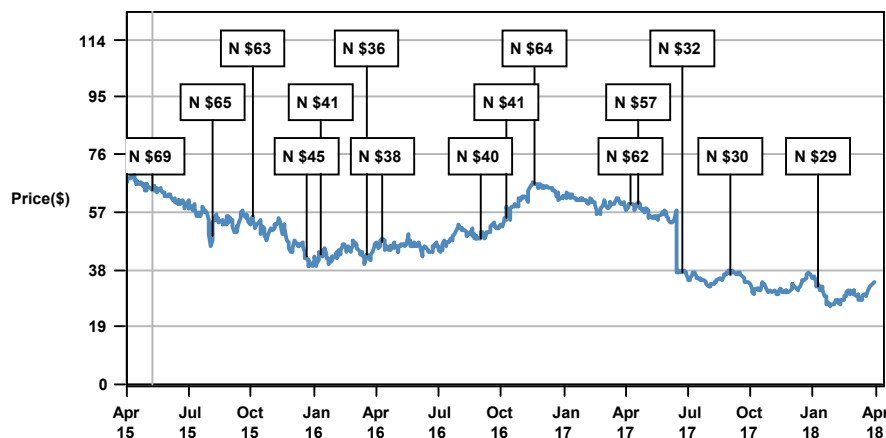
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Baker Hughes (BHGE, BHGE US) Price Chart



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