Transcripts | **Basic Materials**

Baker Hughes Company (BKR) CEO Lorenzo Simonelli on Q3 2019 Results - Earnings Call Transcript

Nov. 2, 2019 11:37 AM ET
by: SA Transcripts

Q3: 10-30-19 Earnings Summary

SEC *10-Q*

EPS of $0.21 misses by $-0.03 | Revenue of $5.88B (3.83% Y/Y) misses by $-231.02M

Earning Call Audio

Subscribers Only

00:00 -58:25

Baker Hughes Company (NYSE:BKR) Q3 2019 Earnings Conference Call October 30, 2019 9:00 AM ET

Company Participants

Judson Bailey - VP, IR

Lorenzo Simonelli - Chairman, President & CEO

Brian Worrell - CFO

Conference Call Participants

James West - Evercore ISI

Angeline Sedita - Goldman Sachs Group

Chase Mulvehill - Bank of America Merrill Lynch

Scott Gruber - Citigroup

William Herbert - Simmons & Company International

Sean Meakim - JPMorgan Chase & Co.

John Anderson - Barclays Bank

Marc Bianchi - Cowen and Company

Kurt Hallead - RBC Capital Markets

Christopher Voie - Wells Fargo Securities

Operator

Good day, ladies and gentlemen, and welcome to the Baker Hughes Company Third Quarter 2019 Earnings Call. [Operator Instructions]. As a reminder, this conference call is being recorded. I would now like to introduce your host for today's conference, Mr. Jud Bailey, Vice President of Investor Relations. Sir, you may begin.

Judson Bailey

Thank you, Katherine. Good morning, everyone, and welcome to the Baker Hughes Company Third Quarter 2019 Earnings Conference Call. Here with me are our Chairman and CEO, Lorenzo Simonelli; and our CFO, Brian Worrell. The earnings release we issued earlier today can be found on our website at bakerhughes.com.

As a reminder, during the course of this conference call, we will provide forward-looking statements. These statements are not guarantees of future performance and involve a number of risks and assumptions. Please review our SEC filings and website for a discussion of some of the factors that could cause actual results to differ materially. As you know, reconciliations of operating income and other non-GAAP to GAAP measures can be found in our earnings release.

With that, I will turn the call over to Lorenzo.

Lorenzo Simonelli

Thank you, Jud. Good morning, everyone, and thanks for joining us. We delivered a solid third quarter with strong growth in Turbomachinery and Oilfield Equipment orders and continued margin improvement in our Oilfield Services business. Overall, we are very pleased with our continued execution as a team, and we are firmly on the right path financially, operationally and strategically.

Before I turn it over to Brian for more details on our financials and outlook, I would like to take some time to discuss what we view as an exciting new beginning for Baker Hughes. During the third quarter, GE sold down a portion of its stake in our company through a secondary offering and concurrent buyback, taking its ownership percentage from just over 50% to just below 37%. This most recent transaction is another major step in our separation from GE. As you know, GE announced their intention to exit their stake in our company over 1.5 years ago, and we've been working on this process since that time. At the end of July 2019, we finalized our separation agreements, which included a number of transitional services.

These are intended to ensure continuity of our operations during the separation period for IT systems and other critical infrastructure. As you have seen in the weeks following the sell-down, we changed our company name, stock ticker and branding. In addition, GE's representation on our board went from 5 seats to 1. These are important, highly visible steps we have taken that outline the direction of the company going forward. While less visible, an equally important near-term impact is the acceleration of our separation efforts as we work quickly to minimize our time in transition and to be fully operational on our own systems as soon as possible. I want to emphasize that these separation efforts are largely focused on back-office functions such as IT, HR and treasury systems and other supporting infrastructure. The commercial and operational front end of our business is largely unaffected by the separation. Although our name change, ownership and board structure are the most visible aspects of this new beginning for Baker Hughes, we are also entering a new chapter as we move into the next stage of our corporate development and prepare for the energy transition we see unfolding over the next decade. 2 years after the formation of our company, we have executed on our integration and synergy targets and are in the early stages of evaluating the optimal portfolio for Baker Hughes, not only in the current environment but into the future. In the coming decades, we forecast natural gas to be the key transition fuel for a lower carbon future as oil demand growth slows and demand for renewable energy sources accelerate. While it is clear that renewables will grow as a share of the overall energy supply, renewable sources will not be able to fulfill global energy demand, given currently available technology and its small footprint today. These dynamics create the opportunity for natural gas to take a more prominent role over the coming years. Our view is that natural gas demand will grow at more than twice the pace of oil, and LNG demand growth will be higher still at an annual rate of 4% to 5%. This creates tremendous opportunity for our businesses. And we will position the company to capture the high-value, higher-technology opportunities along the gas value chain.

In this environment, our strategic goals are simple. First, we will improve margins in our Oilfield Services and Oilfield Equipment businesses. In OFS, we have executed over the last two years on some of the more straightforward synergy areas, such as right-sizing our footprint and facility consolidation to help improve margins. Moving forward, we are increasingly focused on the next stage of margin improvement, which we expect to be driven by supply chain efficiencies, increases in asset utilization and lower product costs for better procurement and standardization. In OFE, we expect margin improvements as growing volumes from backlog conversion should drive cost absorption and allow us to capitalize on significant cost-out initiatives we have implemented in the recent years.

Second, we will leverage some of our unique core competencies in TPS and Digital Solutions to further expand our offerings in the industrial and chemical end markets. We see the opportunity to grow more in the gas value chain with our Turbomachinery segment, grow in the downstream space with our Digital Solutions segment and grow our industrial and chemicals presence across our portfolio. As an example, we have utilized our expertise in gas turbine technology to develop and launch the NovaLT family. This new class of turbine builds on TPS' deep domain experience in the rotating equipment space. This product line targets the industrial markets and lower megawatt applications where we had not previously competed such as distributed power, e-frac and pulp and paper. In our Digital Solutions business, we have leveraged our strengths in inspection technology to enter the automotive and consumer electronics space with limited incremental investment.

Our third strategic goal, we will work to continue to improve our digital offerings to help facilitate better, safer and more reliable operations for our customers through our recent joint venture with C3.ai, which we have branded BHC3. In addition, we will be able to apply C3's offering internally to improve our own operational and execution capabilities. By integrating our strong suite of digital offerings and capabilities, oil and gas industry expertise and C3's unique AI solutions, we will accelerate the overall digital transformation of this industry. As we focus on these initiatives and work to complete the separation from GE, we are also fully aware that we'll be executing against a somewhat challenging macro backdrop.

On the demand side, global crude oil demand appears to be slowing due to a number of factors, most notably trade tensions, which are beginning to manifest into slower growth and weaker manufacturing data in some of the major economies around the world. Recent PMI data has shown slowing momentum for bellwether economies with the most recent data for the United States, China and Eurozone signaling softening demand.

On the supply side, we agree with the view that OPEC may have to consider additional cuts as non-OPEC, non-U.S. production appears poised for solid growth in 2020 as new offshore developments come online. In the U.S., production growth is likely to decelerate but should remain resilient despite the expectation of E&P CapEx cuts next year. Weighing these factors together, we expect an adequately supplied market under most economic scenarios resulting in a range-bound oil price environment for 2020 and potentially beyond.

Despite this macro backdrop, we still feel good about the potential for revenue and margin growth across our portfolio in 2020. We believe the geographical and business mix in our OFS segment should still be conducive to modest growth next year, while our long-cycle business segments should produce solid revenue growth as we execute current backlog and anticipate continued firm order activity. More specifically, within our OFS segment, we are preparing for a North American market that is likely to see another reduction in E&P spending in 2020 as operators exercise capital restraint and seek to improve their free cash flow. Although it's still early, we agree with some estimates suggesting that lower 48 drilling and completion spending could decline in the high single-digit or even low double-digit range in 2020 on a year-over-year basis due to a combination of weaker pricing and lower activity levels.

Internationally, we expect growth to moderate compared to 2019, but we still believe that drilling and completion spend can grow in the mid-single-digit range or higher in 2020 depending on a number of macro factors. International revenue growth for Baker Hughes has significantly outpaced the market trends over the last 2 years as we sought to recapture share and regain critical scale in select regions. Our core focus going forward will be on improving margins. Therefore, I would expect our top line to be more representative of overall international market trends.

Overall, I am generally pleased with the continued performance and execution of our OFS team, the operational improvements they have made and some of their recent contract wins. In the third quarter, OFS had a number of important wins in the Middle East across multiple product lines, including artificial lift, completions and international pressure pumping. We also continue to see progress in our partnership with ADNOC, delivering strong execution as we help to build out ADNOC's drilling capabilities. In North America, we won an important artificial lift contract with a key customer in the Permian, building on our strong relationships and execution capabilities in this important basin. In our OFE segment, we continue to see demand for around 300 trees in 2019 which is roughly flat versus 2018. We also see an opportunity for additional orders in the flexible pipe market in 2019 following a subdued 2018. We were extremely pleased with our orders performance in the third quarter in OFE as we secured some important wins with INPEX GS4, Vår Energi's Balder Field and with Apache in the North Sea. Overall, we remain constructive on the opportunity for order growth in the OFE segment in 2019.

In our TPS segment, order growth remains solid compared to 2018, driven by continued strength in LNG and resilient order activity in our non-LNG businesses. Looking more closely at the LNG market, the project cadence is playing out largely as we expected. So far this cycle, 80 out of the 100 MTPA we outlined earlier this year has reached FID, which includes the recent FID of Venture Global's Calcasieu Pass and Novatek's Arctic 2. Today, our technology drives almost 400 million tons of LNG production capacity. And in this most recent cycle, our technology has been selected for each of the projects that have reached a successful FID. As we look to the remainder of the year and into 2020, we believe there are several large LNG projects still to come, and we are well positioned to win many of them.

Although the year got off to a slow start for the non-LNG portion of TPS, I am very pleased with the progression of non-LPG equipment order intake over the last 6 months. We have been successful in securing awards across a wide range of applications such as electric frac, FPSOs and pipelines while still being selective in the less profitable markets of refining and petrochemical.

During the quarter, we were awarded 2 FPSO contracts, Offshore Brazil and Offshore India, as well as a number of awards in the onshore/offshore production and pipeline businesses.

Lastly, in our Digital Solutions segment, the broad diversified nature of our portfolio and growth in oil and gas and other end markets has helped to partially offset weakness in the power market. Going forward, we generally expect these trends to continue. On the commercial side, only weeks after forming the BHC3 joint venture, the team launched its first artificial intelligence software application, BHC3 Reliability. We are extremely excited about this partnership and the potential it brings to our industry.

That is a short summary of how we see the market today. Overall, we believe that Baker Hughes is well positioned to navigate a potentially choppy macro backdrop. This is enabled by our combination of long-cycle businesses in TPS and OFE, more stable end markets within digital solutions and a differentiated OFS portfolio that is focused on high-technology drilling and completion applications and production-related offerings such as upstream chemicals and artificial lift. I am confident that we have the right team in place to execute our strategy and position Baker Hughes to generate strong free cash flow, improved margins and drive returns.

With that, let me turn the call over to Brian.

Brian Worrell

Thanks, Lorenzo. I'll begin with the total company results and then move into the segment details. Orders for the quarter were $7.8 billion, up 35% year-over-year and up 19% sequentially. This is the highest orders quarter we have seen since the second quarter of 2015. The year-over-year growth was driven by strong orders in Oilfield Equipment and Turbomachinery. We delivered solid growth across both equipment and services with equipment orders up 89% and services orders up 1%. Sequentially, the increase was driven by Oilfield Equipment and Turbomachinery. Remaining performance obligation was $22.2 billion, up 8% sequentially. Equipment RPO ended at $7.4 billion, up 32% sequentially, and services RPO ended at $14.9 billion, down 1% sequentially. Our total company book-to-bill ratio in the quarter was 1.3, and our equipment book-to-bill in the quarter was 1.8. Revenue for the quarter was $5.9 billion, down 2% sequentially.

The sequential decrease was driven by Turbomachinery and Digital solutions, offset by revenue growth in Oilfield Services and Oilfield Equipment. Year-over-year, revenue was up 4%, driven by Oilfield Equipment and Oilfield Services, offset by declines in Turbomachinery and Digital solutions. Operating income for the quarter was $297 million, which is up 10% sequentially and 5% year-over-year. Adjusted operating income was $422 million, which excludes $125 million of restructuring, separation and other charges. Separation charges in the quarter were $54 million. Adjusted operating income was up 17% sequentially and up 12% year-over-year. Our adjusted operating income rate for the quarter was 7.2%, up 120 basis points sequentially and up 50 basis points year-over-year.

Corporate costs were $109 million in the quarter. We expect the corporate line to remain at a similar level for the fourth quarter as we continue our separation efforts. We are investing in systems and processes that enable us to fully separate such as IT, HR and other back-office infrastructure. As we have ramped up the build-out of these systems and not yet transitioned from GE, we are beginning to incur modest additional cost in line with the framework we communicated last November.

Depreciation and amortization was $355 million, down 1% sequentially and up 1% year-over-year. We expect depreciation and amortization to remain at this level in the fourth quarter. Tax expense for the quarter was $107 million. For the fourth quarter, we estimate that our effective tax rate, excluding the impact of onetime separation and restructuring expenses, should be in the mid- to high 30s.

GAAP earnings per share were $0.11, up $0.12 sequentially and up $0.07 year-over-year. Adjusted earnings per share were $0.21, up $0.01 sequentially and up $0.02 year-over-year. Free cash flow in the quarter was $161 million, which is below our expectations. The shortfall was driven primarily by collections and inventory management in OFS. We still expect to see a free cash flow profile in the fourth quarter similar to what we generated in the fourth quarter of 2018, excluding the $300 million progress payment from ADNOC Drilling we received last year.

Now I will walk you through the segment results in more detail and give you our thoughts on the outlook going forward. In Oilfield Services, the team is navigating a challenging North American environment while working to improve our execution globally. As Lorenzo highlighted, we are entering a new phase of cost out and productivity initiatives in OFS, focused on supply chain optimization, improving asset utilization and driving down product cost. Our goal from these various initiatives is not only to improve margins but also improve the overall cash flow efficiency of our OFS business.

The OFS team executed a strong third quarter with revenue of $3.3 billion, which was up 3% sequentially. North American revenue was $1.2 billion, down 3% sequentially. International revenue was $2.2 billion, up 6% sequentially, driven by strong product sales and growth in the Middle East, Asia Pacific, Europe and Latin America. We saw strong execution in our artificial lift, completions and international pressure pumping product lines.

Operating income in the quarter was $274 million, up 18% sequentially. Margins grew 110 basis points, driven primarily by continued cost out and stronger-than-planned product sales. As we look ahead to the fourth quarter, we expect overall OFS revenue to be slightly down sequentially. We expect North America revenues to decline due to further deterioration in drilling and completion activity in the U.S. land market. Internationally, we expect revenue to be roughly flat as year-end product sales should be offset by seasonal weakness in some Eastern hemisphere markets. In addition, we do not expect product sales related to some international contracts to repeat at the same level as the third quarter. Against this revenue scenario, we would expect margins to be roughly flat to slightly down versus the third quarter.

Looking beyond the fourth quarter and into 2020, we believe there are a number of cross currents that will impact our OFS business. As Lorenzo highlighted earlier, our focus is shifting primarily to margin and free cash flow improvement for this business. As a result, we expect our international revenue growth profile to more closely track international D&C spending trends after significantly outperforming over the last 2 years. We believe mid-single-digit international growth is a reasonable expectation. This anticipates execution on the visible work that we have contracted but also risk adjusts for a number of factors, including the potential for additional OPEC cuts and weakness in certain markets like Argentina. In North America, we are preparing for U.S. D&C spend that could be down high single digits to low double digits. Similar to the third quarter, we would expect our top line to outperform market trends, given our production weighted mix with almost 40% of our OFS revenue driven by upstream chemicals and artificial lift. Under this revenue outlook, we expect modest margin improvement in 2020 aided by our cost-out and productivity actions, and our long-term goal remains margin parity with peers.

Next, on oilfield equipment. Orders in the quarter were $1 billion, up 86% year-over-year, driven by strong growth in both equipment and service orders. Equipment orders were up 122% year-over-year, driven by Subsea Production Systems and flexibles and services orders were up 31%. Equipment book-to-bill in OFE was 1.7 for the quarter. Overall, we continue to believe that order activity for subsea trees and flexibles are returning to a more normalized level. We booked several key awards in the quarter, including 16 trees for Vår Energi's Balder project, 7 trees for INPEX in Australia and 6 trees for Apache in the North Sea. Importantly, the Balder project represents our first subsea tree award on the Norwegian Continental shelf since 2008. Revenue was $728 million, up 15% year-over-year. This increase was primarily driven by better Subsea Production Systems volumes and subsea services activity, partially offset by lower revenues and flexibles. Operating profit was $14 million, up $8 million year-over-year, driven by increased volume in SPS and subsea services. Although operating income was higher year-over-year, sequential margin performance in OFE was below our expectations, primarily due to weaker results from our surface pressure control business. Looking into the fourth quarter, we expect modest revenue growth and sequential margin improvement, driven by similar mix dynamics to what we saw in the third quarter. Following 23% orders growth in 2018 and what should be solid orders growth in 2019, we believe that OFE should see 2020 revenue growth in the high single-digit range as we convert backlog into revenue. We expect volume growth, combined with our cost-out actions and improving mix from flexibles, to drive solid margin improvement in OFE in 2020.

Moving to Turbomachinery. Orders in the quarter were $2.8 billion, up 79% year-over-year. Equipment orders were up over 200% year-over-year. The growth was driven by very strong orders in LNG and onshore/offshore production. TPS equipment book-to-bill in the quarter was 4.9, supported by the large award for Venture Global's Calcasieu Pass as well as 2 FPSO orders. After a slower start in 2019, we have seen non-LNG equipment awards begin to normalize to quarterly levels that we saw in 2018, supported primarily by orders within our onshore/offshore production and pipeline segments. Service orders in the quarter were down 13% year-over-year, mainly driven by fewer upgrades and installations. Revenue for the quarter was $1.2 billion, down 14% versus the prior year and down 15% sequentially. TPS revenues this quarter were impacted by supply chain issues with a key supplier and some other equipment delivery delays. Operating income for Turbomachinery was $161 million, up 22% year-over-year, driven by higher services mix. Operating margin was 13.5%, up 390 basis points year-over-year and up 380 basis points sequentially. For the fourth quarter, we expect TPS to see modest year-over-year growth in both revenues and margins versus the fourth quarter of 2018. Given our strong orders year-to-date and visibility for other awards the rest of the year, we continue to expect strong order growth for the full year 2019, driven by LNG awards.

Looking ahead to 2020, we expect high teens revenue growth based on our 2018 and 2019 order intake and for margins to continue to expand. For orders, the outlook for 2020 runs a fairly wide range, depending on the exact timing of when orders are booked between late this year and early next year.

Finally, on Digital Solutions. Orders for the quarter were $616 million, down 2% year-over-year. Growth in our Bently Nevada and Measurement & Sensing businesses was partially offset by declines in controls and pipeline and Process Solutions. Regionally, we saw strong orders growth in North America and Europe. Revenue for the quarter was $609 million, down 7% year-over-year. Growth in Measurement & Sensing was offset by declines in controls and pipeline and Process Solutions. Operating income for the quarter was $82 million, down 23% year-over-year, driven by lower volume and negative mix. In the fourth quarter, we expect revenue in Digital Solutions to be down mid-single digits year-over-year and for slightly lower margins year-over-year as weakness in the power markets remain a drag on operations. Looking ahead to 2020, we expect revenue growth in the low single digits and modestly higher margins.

With that, I'll turn the call back over to Jud.

Judson Bailey

Thanks. With that, Katherine, let's open the call up for questions.

Question-and-Answer Session

Operator

[Operator Instructions]. And our first question comes from James West with Evercore ISI.

James West

Lorenzo, curious about the TPS business. As we think about first to fourth quarter but also in 2020, it seems to be a big driver of Baker going forward and how you're thinking about the order rate. Clearly, we're probably going to get to your 100 million tons per annum forecast that you had for this year. But then looking into next year, kind of what do you see for that?

Lorenzo Simonelli

Yes, James, first of all, let's maybe kick off with the LNG and also what we've been seeing this year overall for orders. And we feel good about the orders for TPS in 2019. As you mentioned, 80 of the 100 million tons has already taken place. And as you look at getting up to the 100 million tons, there's plenty of projects that are underway. So we feel good about the positive orders in 2019.

And as you look at LNG overall, over the course of the next few years, there's going to be increasing project activity. You've got an outlook of a demand of 550 million tons by 2030. And to put that into perspective, you're going to need to have about 650 million tons of nameplate capacity in place to actually provide that.

So as you look at the outyears, LNG activity is going to continue, and we feel conservatively, there's going to be more, 75 million to 100 million tons that's going to actually be taking place. And you've got a number of those projects that you can see actually that have been approved by FERC or internationally that are going to be coming through. So we feel good about LNG over the long term.

When you look at TPS orders and you look at 2020, specifically, as Brian mentioned in his remarks, there is an aspect of the timing of these projects. So I'd say that, again, you're going to see LNG projects, but there could be some reduction in 2020 but no more than 10% or a little bit more than that. And basically, we've got the other segments of TPS that continue to look favorable as they continue to grow as well. So 2020, again, may see some drop, but it's going to be based on project timing.

James West

Got you. Okay. And then maybe just a follow-up for me on the margin side for TPS. It sounds like Brian mentioned similar to last year's margin in 4Q, so it's a nice uptick. But even if we look at 2020, even with the mix shift may be away a bit from LNG more on the non-LNG side, what does that do to the margin progression?

Brian Worrell

Yes, James. Look, as I said earlier, for the fourth quarter, we do expect TPS to see modest year-over-year growth in both revenues and margins versus the fourth quarter of 2018. As you see, we have a natural margin ramp in the fourth quarter and would expect that to continue.

And look, as you look at next year, there are a few dynamics to think about that are building blocks for how the margin rate is going to play out. First, we do expect growth in service revenue, which, as you know, is accretive to our margins. We'll also see higher LNG equipment revenue, which really has 2 effects. It's accretive -- LNG margin is accretive, but with much larger equipment revenue versus services, it will lead to a bit of a mix challenge at that macro level. And we are in the early stages of executing on 2 LNG awards, and those will ramp next year, Arctic 2 and BG, which tend to have their lowest margin rates at the beginning of the projects and accrete over time as you execute. So that will also have a bit of an impact on margins as well.

And then lastly, look, we're evaluating our overall technology-related spending next year as we're looking to find the optimal level, given the competitive dynamics in this space as well as where we're moving the portfolio over the course of the next few years. So look, I think if you add it all up, you'll find that the faster revenue grows, especially in equipment, it somewhat impacts the magnitude of the upside and the increase in margins. But look, I think the third quarter gives you a little bit of perspective in terms of the dynamics where we converted less equipment backlog into revenue, had higher service mix and as you know, had incredibly strong margins above 13%.

So look, our overall goal in TPS is to continue to drive margins up in the mid- to high teens over the coming years as revenues normalize and our service revenues continue to grow, but the overall dynamics for TPS are positive for both revenue and margin accretion over the foreseeable future.

Operator

And our next question comes from Angie Sedita with Goldman Sachs.

Angeline Sedita

So on the service mix, I think it's a little bit underappreciated as far as the quantity in your backlog and the visibility it provides. So maybe you could talk a little bit about service revenue or essentially aftermarket. And I believe it's 60% of your TPS revenues and 60% of your $20 billion in backlog, which gives you a nice earnings visibility versus your peer set. So maybe you could talk about service set revenues in general and the pace of growth over the next 2 to 3 years?

Brian Worrell

Yes, Angie, you're right. Service revenue is roughly about 60% of TPS revenue over time. We're pleased with how that business is performing. The revenue is really driven by both transactional and contractual services, where we provide services for customers' equipment on an ongoing basis, really, effectively creating an annuity revenue stream, as you and I have discussed before. And it does make up about $13 billion of the services backlog that we have in TPS.

And as I was mentioning in the other -- the question that James asked, it tends to be higher margin than the rest of the portfolio. And look, that's really about continuing to add value for customers and getting the compensation for ensuring that their equipment operates efficiently, the uptime is there and that we don't cause disruption to their equipment. So getting paid for that value is absolutely important. And Rod and the team are continually focused on how to continue to add value to customers.

Year-to-date transactional and contractual service revenues are up 6%, so solid growth there. And if you look at where we expect 2020, I would think that revenues would continue to grow at a steady pace, really driven by the visibility that we have into customer maintenance schedules and the outage schedules and the growth that we've seen in equipment orders in 2018 and 2019. They will generate incremental service revenue streams. Some of that will come in next year from orders that we took in '16 and '17. And we'll continue to add to the backlog as we start to see service orders come in for equipment orders that we booked over the last couple years.

So look, overall, to your point, I think it does create some really good visibility into the top line performance of the business. And obviously, that translates into nice earnings in the TPS and it gives us confidence about the long-term potential of the business. So look, it's a great franchise. But Angie, it's all about continuing to provide value to the customers, and that's what we're focused on doing.

Angeline Sedita

Very, very helpful. And then given the importance of free cash flow in this market, can you talk us through Q3? We had roughly $161 million in free cash flow in Q3. I think you had $355 million in Q2? So can you talk a little bit about why it was light? Was it working capital? And thoughts on free cash flow conversion and working capital into Q4 and next year.

Brian Worrell

Yes. In general, Angie, as I take a look at third quarter and the fourth quarter, very pleased with how TPS and Digital Solutions are tracking year-to-date and for the year. OFE is roughly in line with where we thought it would be, so pretty much down the fairway in terms of expectations.

OFS is a little behind where we wanted them to be right now in terms of collections and inventory. Look, their revenue was up 12% year-to-date. So quite a bit stronger than our peers. So working capital is a natural headwind, but they still haven't generated as much cash from working capital as we'd planned, given some of the process changes that we've been driving in that business for the last year or so. The team is working on this. We actually had a new head of supply chain come in early in the quarter, and he's already revamped the purchasing and inventory processes in OFS. And look, we'll start to see some of those results come through in the fourth quarter. I would expect the working capital to normalize in the fourth quarter. And as you know, the typical seasonal cadence for an OFS business is a working capital build in the first half, and you see a release in the second half as collections fall through on a net basis.

So look, our goal in the fourth quarter is to do better than last year, and we're working to improve a number of processes in working capital. Specifically around the fourth quarter, like I said earlier, we do expect to ramp in fourth quarter. And I'd expect us to do at least what we did in 4Q '18, excluding the $300 million progress payment that we had from ADNOC. So feel good about the process changes we've implemented, how the teams are performing. All the working capital metrics are up year-over-year. So definitely seeing progress there.

And then I'd say, in general, Angie, we're experiencing normal linearity of free cash flow. And I don't see anything that would change our ability or our capability and commitment to 90% free cash flow conversion over time.

Operator

And our next question comes from Chase Mulvehill with Bank of America.

Chase Mulvehill

I guess I'll come back to TPS real quick. It looks like there was maybe $200 million of revenue that was pushed out. And it looks like it's going to all kind of come back in the fourth quarter. Could you maybe just help characterize the $200 million that was pushed out? And how much of that was associated with the supply chain issues? And then I'm assuming the supply chain issues are resolved.

Lorenzo Simonelli

Yes. Chase, unfortunately, as was mentioned, we did have some supply chain delays from a key supplier of critical equipment. That has resulted in some delays of the project timing. I want to make clear these delays are not related to quality or performance. They're just simply timing delays, and we're seeing a few constraints on our supplier to deliver those. But we know the team is doing everything in their power to work through the challenges. We're confident that the team is going to be able to manage this and will work through these challenges going forward.

Brian Worrell

Yes. And Chase, I'd say, look, delivery schedules in this business can move around a fair amount, given customer project timing, when they want to pick up equipment, site readiness, those kind of things. But some of the recent delays have been a little more abnormal and could persist as we work through these delays with our supplier.

If you take a look at the revenue decline in TPS, roughly half of that decline comes from business dispositions, primarily the impact of the recip disposition as well as NGS. So that gives you a little bit of color in terms of what the decline is there. And look, all the revenue isn't pacing exactly where we wanted it, given some of these delays. Look, we are pleased with the margin at over 13% in the quarter. And look, it's -- there is some mix there, but it's also a reflection of some of the cost-out programs that Rod and the team have been executing over the course of the past year. And look, I don't see any issues with the framework that we talked about from a TPS standpoint and that ramp-up of revenue in the fourth quarter increasing year-over-year. So feel good about that, and that includes the impact of potential delays from the supplier that Lorenzo and I had mentioned.

Chase Mulvehill

Okay. All right. That's helpful. I appreciate the color. And then also hitting on OFS a bit here. It's good to hear that, 2020, there's going to be a focus on margin improvement versus kind of top line growth. I don't know if you've got anything you want to share with us on cost initiatives, maybe framing some numbers around there. Or in particular, maybe on the margin side, if you want to just -- if there's anything on the targets about how much you think that international margin can improve in 2020 as you focus more on the margin side.

Brian Worrell

Yes, Chase, I won't give specific numbers for each individual category, but we've got a lot of things that we're driving in OFS to improve margins. I'd say, first, you hit on one, the international revenue. We did win some large contracts, started executing on those this year. So the natural progression of those contracts, we'll see margin improvement as we come up the learning curve, are fully deployed and have all the assets and people that are out there engaged full time. So you'll see a natural lift there.

In terms of some other things that we're working, we've completely revamped how we do our job planning. Our asset management, deployment of people around the world, we've been able to optimize that. So we'll start to see some impacts come through there. We're starting to see improvements in repair and maintenance cycle times and working closely with suppliers to drive cost out and better cash efficiency as we work through cost out in OFS. Really focused on supply chain and reducing structural costs globally. This is the next phase beyond the early days of synergies that we were driving, and we've been working this for quite some time now. So it's not like we're just waking up today and putting new programs in place. So we will continue to see costs go down and better asset utilization and more efficient deployment. So Maria Claudia and the team are firmly focused on this and have a strong pipeline of margin improvement projects.

Operator

And our next question comes from Scott Gruber with Citigroup.

Scott Gruber

Just staying on Chase's question, a lot of moving pieces on the cost side in OFS. But Brian, can you give us some color just what does modest margin improvement in 2020 equate to in terms of incrementals? And the same for OFE where margin improvement should be solid, what does that mean for incrementals next year?

Brian Worrell

Yes. I think the way to think about it is -- given the dynamics that we talked about in the revenue, and there's still a lot of moving pieces in 2020. So it's hard to call an exact number in terms of where the margin is going to be. Some of it's going to depend on mix of business. But I will say that we feel very confident, given the dynamics that we see today, that we will see margin improvement in OFS really driven by those things that I just highlighted in Chase's question.

So look, I think moving over to OFE, we've talked a lot about what Neil and the team have been driving during this downturn. We're starting to see the backlog get better. There's a lot of benefits from volume leverage coming through with all the costs that we've taken out. And look, I feel pretty good with the high single-digit range on revenue, and that should be mid-single-digit improvement in operating margins.

Scott Gruber

And just on OFS. I think you guys in the past have talked about 25% or so incrementals is normal. Correct me if I'm wrong. But do you think you're going to eclipse that next year? Can we start with a 3 handle?

Brian Worrell

Yes. I mean, look, again, incrementals are so tough to call on, just given the mix of business, both geographically and the span of products that we have and where they are. But look, I think with the dynamics that we see today, you've seen a very strong quarter this quarter. I'd say with the cost out that we're driving, if things play out in the market like they are right now, I would expect to see stronger incrementals come through.

But again, it's still early days. We're in October here, and there's a lot that's got to happen by December of next year. But look, the momentum is there with the team, and you can rest assured that we'll be able to drive cost out and improve margins next year. The magnitude will depend on how some things in the market play out.

Operator

Our next question comes from Bill Herbert with Simmons.

William Herbert

So most of my questions have been asked -- answered, yes. Well, there's just one quick one for me. Trees, you called out 300 industry awards for this year, flat year-over-year. What's your prophecy for 2020? Similar order cadence or higher or lower?

Lorenzo Simonelli

Yes, Bill, I just -- I think the question was a little muffled. So I'll just try to repeat it and make sure that that's the correct question. You were asking about tree counts. And we've said before that 2019 looks like around 300 trees, same as 2018. Is that correct?

William Herbert

Yes, sorry. So my question -- yes, my question really was more for the tree count for 2020.

Lorenzo Simonelli

Yes. No, no. And look, as we look at 2020, we continue to see a similar type of market for the offshore tree counts and so looking to be at around 300 trees. There's good project activity. So it's stabilizing. And again, we think we'll be having a similar type of market representation as we did in 2019.

Operator

And our next question comes from Sean Meakim with JPMorgan.

Sean Meakim

So nice inbound on OFE, obviously, some good named projects that you called out. Can you maybe help frame for us how many Subsea Connect projects would you say are out there for the next 12 to 24 months? And how would you size that opportunity set relative to the more traditional procurement type awards?

Lorenzo Simonelli

Yes, Sean. So as you know, we did launch Subsea Connect at the end of last year and also the Aptara family suite of both trees as well as flexibles, composites. So we've seen a lot of good traction with the customers. And actually, we're already starting to incorporate many of the Aptara capabilities into some of the projects that are being executed at the moment. As we go forward, we're always going to be listening to what the customer wants and making sure that we can standardize where possible and provide them the most efficient solution. There is new modular deepwater technology that is being requested by the customers, and we've got a great capability there. So our commercial approach is going to remain flexible based on what the customers want. And again, we think our market position is going to hold as we go forward. And we feel good about the portfolio we've got in OFE.

Sean Meakim

Fair enough. I appreciate that. So staying with OFE, flexible pipe has been a bit of a drag. Supposed to help the mix in '19, maybe we're not quite there yet. Is that taking a bit longer than expected? And just how does your expectation for flexible pipe influence the guide that you framed for 2020?

Lorenzo Simonelli

Yes, Sean. I'll just maybe go back and rephrase 2019 and then I'll pass it over to Brian with the margin. We always said that 2019 was going to be a rebuilding of the order backlog for flexibles. And we've actually seen that. And it was driven by the fact that Petrobras did not play actively in the flexible side in 2018. And if you look at year-to-date, we're up 130% on SPS orders. So we feel good about what we said about rebuilding the backlog coming through in 2019 and then being converted next year.

Brian Worrell

Yes. And Sean, I think if you put that in perspective of OFE in total, look, we expect to see, like I said, high single-digit revenue growth, which will lead to mid-single-digit margins in the year. And really, that's driven by strong SPS revenue growth. We saw 20% orders increase in 2018, 16% year-to-date. And Lorenzo highlighted that SPS will be back, and that's roughly 20%, 25% of the business over time. So that will be a tailwind. The drag we expect to be is the surface pressure control business like we highlighted this quarter. The North American market remains pretty challenging. Specifically, we're taking cost out there, but I would expect that to be a drag on margins next year in OFE, but that's incorporated in the mid-single-digit number that we talked about.

Operator

Our next question comes from David Anderson with Barclays.

John Anderson

A question on the -- a question on the artificial lift contract that you announced today. You haven't talked about this business very much recently. I just wonder if you could talk about the growth potential you see here. You had noted that 40% of your North -- if I heard you right, North American revenue is on the chemicals and artificial lift side. Can you just talk about the prospects for that? It seems like it's fairly competitive. But at the same time, if we're in a flattish market, how do you see the business prospects?

Lorenzo Simonelli

Yes, Dave. And again, our artificial lift, and we like the portfolio we have. In particular, if you look at the focus areas on ESPs, where we've got the strongest part of the market, and we're seeing actually an increased adoption of ESPs when you look at different basins within North America. And that's where the contract that we announced actually is taking place is on ESPs. As you look at Rod Lift, it continues to be a challenging market. So no major shift really that we're seeing in the marketplace towards gas lift right now. So ESPs is our focus area.

John Anderson

And I was just curious about the digital opportunity in artificial lift as your C3.ai partnership ramps up and you announced that application, that Reliability application. Just kind of curious, do you see opportunities here on the lift side? If you're with the majors, I would assume that the majors might be more willing to go the digital route on this.

Lorenzo Simonelli

Yes, Dave. No, you're exactly right. And if you look at the C3.ai suite, it's really around the aspect of reliability and also production optimization. So we are working actively with some of our customers on deploying the C3 suite. We introduced, obviously, BHC3 reliability, and we'll be working towards other solutions as well. But reducing nonproductive time on the artificial lift is key, and this is a tool that will allow us to do that.

Operator

Our next question comes from Marc Bianchi with Cowen.

Marc Bianchi

I first wanted to start on the cash flow. Brian, you mentioned some nice guidance for fourth quarter comparing to last year. But as we look to '20, you've given us a lot of components for modeling '20. Can you comment on what sort of conversion you would expect in '20? I know you've got the longer-term target of conversion, but what should we expect here as we roll into 2020?

Brian Worrell

Yes, Marc, I'm not really going to give specific guidance at this stage on '20. But if you look at the building blocks, we expect earnings to grow. It's positive for cash flow. Restructuring spend will go down, but that will be offset somewhat by the increased separation spend that we talked about in November 2018, and we started to see coming through this quarter from a free cash flow standpoint. And look, we still have a lot of work going on around working capital, and I would expect the overall working capital metrics to improve.

In terms of CapEx, in dollar terms, I think it will be roughly flat to 2019. But as a percent of revenue, it will be lower as we expect to see outsized growth in TPS and OFE, which are much less capital intensive.

So look, I think with those building blocks, you can take a view on the things we talked about earlier in terms of how we expect 2020 to play out now and come up with a pretty constructive view on free cash flow and free cash flow conversion for 2020.

Marc Bianchi

Okay. And then maybe on the OFS side, looking at the mid-single-digit international growth that you're talking about for '20. If I kind of keep your fourth quarter run rate flat just based on a really strong exit rate that you've got here throughout 2019, you're kind of already set up for that mid-single-digit growth. So is the implication that you see things sequentially pretty flat from here internationally? Or is that perhaps some conservatism?

Lorenzo Simonelli

So again, maybe let's go back to what we said relative to our focus in OFS being on margin accretion. And again, we see the international market being mid-single-digit growth. We feel good about the contracts we've brought on and also the execution of those. We're also taking into account seasonality. 1Q is going to be down as normal. And then also some of the elements on volatility with respect to does OPEC have to cut. So we feel very good about the mid-single digit, and that's what we're focused on is really mid-single-digit and the margin expansion continuing in Oilfield Services.

Operator

And our next question comes from Kurt Hallead with RBC.

Kurt Hallead

Lorenzo, you definitely got my attention in the context of your commentary around natural gas growth longer term and the dynamics around what that may mean for the portfolio of businesses within Baker Hughes, and I'm sure you haven't really gotten to the point of really fine-tuning that dynamic. But I just kind of -- since you did kind of reference it, what -- at a high level, what do you think Baker currently doesn't have that they may need to participate in that market dynamic?

Lorenzo Simonelli

Yes. Great question. And simply put, I think we've got a great portfolio already today, and we've got no plans for major M&A at this time. If you look at our portfolio, we've got high differentiated product companies that can take advantage of the gas theme and the gas value chain. If you look at our rotating equipment business, clearly, with the LNG aspect on OFE, we are predominantly on the gas side. And we've got great capabilities there. As you look at also on the Oilfield Services side, history on the gas perspective. So we've been long on gas for some time. And again, with our portfolio, we think we are going to be a natural partner for the energy transition with our customers. So I think portfolio-wise, we're in a good shape.

Kurt Hallead

I appreciate that color. And maybe delving into the other topic that's come up here quite a bit recently is on the digital dynamics taking place and the transition and transformation taking place there. Just kind of curious as to what you think the addressable market of implementing these Digital Solutions could be within the energy space? And when do you think that, that kind of revenue stream can start to have an impact on the P&L?

Lorenzo Simonelli

I think it's early days on the digital journey, but clearly, they're twofold. First of all, as you looked at internally ourselves, we're applying C3.ai capability, and that will lead to improvements in productivity from a Baker Hughes perspective. Also externally, as we go to our customer base, it's going to help as we provide them solutions to improve their productivity as well. To put an exact dollar number on market size, I think, is premature at this stage. It is significant. And again, I think there'll be Software as a Service that becomes something that is talked about in the future, but the analytics are being developed at the moment. And there's definitely a mix step of productivity that's going to be derived by the Digital Solutions we're deploying.

Operator

Our next question comes from Chris Voie with Wells Fargo.

Christopher Voie

Just curious, you mentioned the prospects for OPEC cuts a few times. If that was going to take place, obviously, Middle East margin would suffer from cost absorption. But is the work you'd lose also be on the high end of the margin spectrum or the low end? Just curious if there's a read-through for the kind of decrementals you might see from that.

Lorenzo Simonelli

Yes. There's a -- as you look at -- and again, OPEC and the decisions that they'll take, there is some correlation that you look at rig count and what OPEC is going to be deciding to do here. And we don't, again, see an impact on our mid-teen growth level that we have for international. We're taking some of that into account.

Brian Worrell

And that's mid-single-digit growth.

Lorenzo Simonelli

Yes, that's correct. So as you look at the OPEC decision again, we'll see what happens. A lot is going to be dependent on the December meeting.

Christopher Voie

Okay. And then just a follow-up on Marc's question on cash flow building blocks in 2020. Just curious if there's an impact in terms of all these TPS orders. You don't book the revenues until the projects are coming online, but I think you're getting some cash inflows related to the work you're doing. Do we have to think about a component of a cash flow headwind in 2020 or 2021? Or is that going to average out based on the other moving pieces?

Brian Worrell

Yes, look, it averages out based on the other moving pieces. And you're absolutely right with some of these orders coming in, you do get some down payments, you build up inventory, but you get progress payments throughout to offset that inventory and work the cash curve. So I'd say it balances out, and there are other things that we're working to make sure we can have strong free cash flow conversion as you look at 2020.

Operator

Thank you. Ladies and gentlemen, thank you for participating in today's conference. This concludes the program. You may now all disconnect. Everyone, have a great day.