

Baker Hughes Incorporated

BHI.N BHI US

EQUITY: AMERICAS OIL SERVICES & EQUIPMENT

Market Share Losses Continue

Quick Note

Summary

Revenue declines continue to pile up for BHI at a higher rate than its peers. Top-line results for 1Q showed a 21% sequential decline, compared with q-o-q declines of 16% for SLB and 17% for HAL. Revenue was 8% lower than our forecast. Adjusted EBITDA fell short of our estimate by 21% (adjusting for several one-time items, including \$124mn before tax in the geography groups). BHI's margins remain somewhat compressed due to an extra 500bps of operating costs held in retention as stipulated by the merger agreement with HAL, but we continue to believe that the revenue trends are a more important consideration for the company, as we see continued market share erosion as evidence that BHI's competitive position has weakened vs. its large-cap peers.

The company's outlook for the rest of 2016 is bleak. BHI expects a 30% decline in the North American rig count in 2Q (seasonality in Canada will factor in). Perhaps more troubling is the outlook internationally, where BHI is anticipating a "steady drop" in the rig count through the end of this year. We think today's results and the weak outlook through year-end are likely to put the shares under pressure today.

Highlights of 1Q Results

- **BHI** reported an adjusted LPS of \$1.58. From the results, we excluded \$0.64 per share in one-time charges related to impairment and restructuring charges, merger and related costs, and loss on firm purchase commitment. The adjusted LPS included \$1.14 per share of tax valuation allowances and \$0.14 per share of one-time charges in Latin America and Europe/Africa/Russia Caspian. Excluding these charges, LPS would have been \$0.30, vs. our estimate of \$0.25 and consensus of \$0.34.

Total revenue in 1Q16 was \$2,670mn, a decline of 21% sequentially. Revenue was 8% lower than our estimate of \$2,898mn and 6% lower than consensus of \$2,851mn. Adjusted EBITDA was \$108mn, versus our estimate of \$228mn and consensus of \$263mn. Excluding one-time charges of \$57mn in Latin America and \$16mn in Europe/Africa/Russia Caspian, adjusted EBITDA would have been \$181mn.

- **North America:** Revenue declined 28% q-o-q to \$819mn. BHI posted an operating loss of \$174mn, vs. an operating loss of \$127mn in 4Q15. Operating margin was -21%, versus our estimate of -18% and consensus of -17%.
- **Latin America:** Revenue was \$277mn in 1Q16, 35% lower sequentially. Operating loss was \$66mn, compared with operating income of 15mn in 4Q15. Operating margin was -24%, versus our estimate of 3% and consensus of 2%. Excluding the impact of a \$42mn of provisions for doubtful accounts related to cash collection challenges from a customer in Ecuador and a local non-income tax related expense of \$15mn, the operating margin would have been -3%.

Global Markets Research

27 April 2016

Rating Remains	Neutral
Target Price Remains	USD 38.00
Closing price 26 April 2016	USD 45.80

Research analysts

Americas Oil Services & Equipment

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- **Europe/Africa/Russia Caspian:** Revenue declined 15% q-o-q to \$611mn. Operating loss was \$19mn, compared with operating income of \$48mn last quarter. Operating margin was -3%, versus of our estimate of 2% and consensus of 4%. Operating margin was affected by foreign exchange losses and doubtful accounts provisions by 2.6% in this quarter.
- **Middle East & Asia:** Revenue declined 12% q-o-q to \$718mn. Operating income increased by 58% q-o-q to \$49mn. Operating margin was 7%, compared with 4% in 4Q16. Operating margin was higher than our estimate of 3% and consensus of 5%.
- **Industrial Services:** Revenue was \$245mn, a decline of 14% sequentially. Operating loss in this quarter was \$4mn, vs. operating income of \$22mn in 4Q15. Operating margin was -2%, versus our estimate of 8% and consensus of 6%.

Fig. 1: Earnings Comparison

\$ in millions except per share data

in millions except per share data

Baker Hughes Inc. (BHI)

Quarterly Comparison

	1Q16 vs. Nomura			1Q16 vs. Consensus			Sequential		Annual	
Metric	1Q16A	NMR est	% diff	1Q16A	Consensus	% diff	4Q15A	% chg	1Q15A	% chg
North America	819	887	(7.7%)	819	868	(5.6%)	1,137	(28.0%)	2,006	(59.2%)
Latin America	277	385	(28.1%)	277	361	(23.3%)	428	(35.3%)	493	(43.8%)
Europe/Africa/Russia Caspian	611	636	(4.0%)	611	633	(3.5%)	723	(15.5%)	895	(31.7%)
Middle East & Asia	718	738	(2.7%)	718	746	(3.8%)	820	(12.4%)	916	(21.6%)
Industrial Services	245	252	(2.7%)	245	264	(7.2%)	286	(14.3%)	284	(13.7%)
Revenue	2,670	2,898	(7.9%)	2,670	2,851	(6.3%)	3,394	(21.3%)	4,594	(41.9%)
North America	(174)	(160)	(9.0%)	(174)	(150)	(16.0%)	(127)	(37.0%)	(50)	(248.0%)
Latin America	(66)	12	671.1%	(66)	6	1,200%	15	540.0%	45	246.7%
Europe/Africa/Russia Caspian	(19)	13	249.3%	(19)	23	182.6%	48	139.6%	(20)	5.0%
Middle East & Asia	49	22	121.3%	49	34	44.1%	31	58.1%	62	(21.0%)
Industrial Services	(4)	19	120.7%	(4)	15	126.7%	22	118.2%	10	140.0%
Segment Operating Income	(214)	(94)	(128.0%)	(214)	(72)	(197.2%)	(11)	(1,845.5%)	47	555.3%
Adjusted Operating Income	(246)	(119)	(107.4%)	(246)	(113)	(117.7%)	(40)	(515.0%)	(2)	(12,200%)
Interest Expense, net	(55)	(54)	(2.7%)	(55)	(55)	0.0%	(55)	0.0%	(54)	(1.9%)
Income (Loss) Before Income Taxes	(301)	(172)	(74.8%)	(301)	(172)	(75.0%)	(95)	(216.8%)	(56)	(437.5%)
Taxes	104	60	73.2%	104	29	260%	(2)	(5,317%)	20	421.7%
Income from Continuing Ops	(197)	(112)	(75.7%)	(197)	(137)	(43.6%)	(97)	(102.7%)	(36)	(446%)
Adjusted Net Income	(197)	(108)	(82.3%)	(197)	(137)	(43.6%)	(93)	(111.5%)	(32)	(515%)
Adjusted EPS	(\$0.44)	(\$0.25)	(80.9%)	(\$0.44)	(\$0.34)	(30.7%)	(\$0.21)	(109.8%)	(\$0.07)	(507%)
EBITDA	108	228	(52.7%)	108	263	(58.9%)	376	(71.3%)	458	(76.4%)
Effective Tax Rate	34.7%	35.0%	(1.0%)	34.7%	16.9%	105.6%	(2.1%)	(1,746%)	35.7%	(2.9%)
EBIT Margin	bps diff			bps diff			bps diff		bps diff	
North America	(21.2%)	(18.0%)	(325)	(21.2%)	(17.3%)	(396)	(11.2%)	(1,008)	(2.5%)	(1,875)
Latin America	(23.8%)	3.0%	(2,683)	(23.8%)	1.7%	(2,549)	3.5%	(2,733)	9.1%	(3,295)
Europe/Africa/Russia Caspian	(3.1%)	2.0%	(511)	(3.1%)	3.6%	(674)	6.6%	(975)	(2.2%)	(88)
Middle East & Asia	6.8%	3.0%	382	6.8%	4.6%	227	3.8%	304	6.8%	6
Industrial Services	(1.6%)	7.7%	(932)	(1.6%)	5.7%	(731)	7.7%	(932)	3.5%	(515)
Total	(8.0%)	(3.2%)	(478)	(8.0%)	(2.5%)	(549)	(0.3%)	(769)	1.0%	(904)

Source: Company data, FactSet, Nomura research

Appendix A-1

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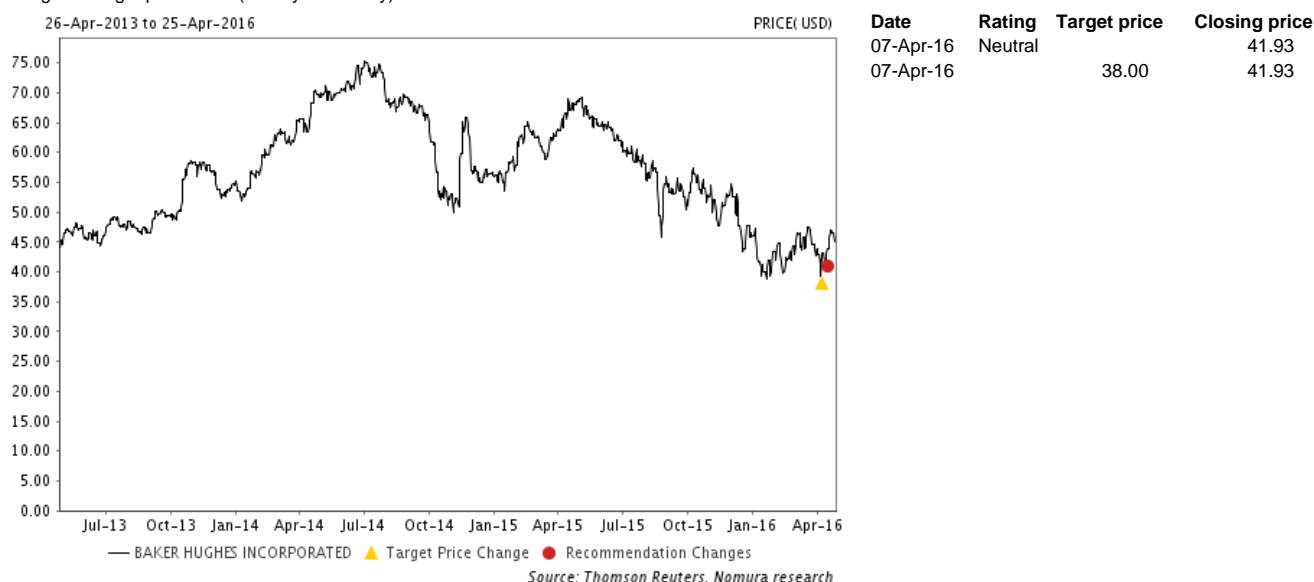
Materially mentioned issuers

Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Baker Hughes Incorporated	BHI US	USD 45.80	26-Apr-2016	Neutral	Not rated	

Baker Hughes Incorporated (BHI US)

USD 45.80 (26-Apr-2016) Neutral (Sector rating: Not rated)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value a standalone Baker Hughes Incorporated (BHI) at \$31 per share, based on a 9x multiple of our 2017 EBITDA estimate. Our target multiple represents a premium to the historical forward median multiple for BHI, which we think is appropriate given our outlook for earnings growth beyond next year in the event of an E&P spending recovery. Based on 4/6 closing prices, the deal terms imply a \$59 share price for BHI if the deal closes. Our target price of \$38 reflects a 25% probability of the deal closing. We use a relative value framework for our coverage, which compares debt-adjusted EBITDA growth metrics with current multiples. We consider changes to future debt-adjusted growth profiles and balance sheet risk in our methodology. The benchmark index for this stock is the Philadelphia Stock Exchange Oil Service Sector Index (OSX).

Risks that may impede the achievement of the target price Upside Risk: A successful completion of the merger with HAL represents ~38% potential upside based on BHI's 4/6/2016 closing price. Downside Risks: 1) A sustained decline in global oil prices would curtail new capital investment in upstream projects, which in turn would further impair demand for BHI's services. 2) BHI executes demanding service contracts across all manner of oil and gas basins, including the deepwater and unconventional plays. An accident that damaged property or caused environmental damage could impair the financial position of the company. Oil services stocks' performance can fluctuate and, therefore, so can potential returns.

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