Baker Hughes at Evercore ISI Elite Energy & Materials Summit

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Corporate Speakers:

- James West; Evercore ISI; Senior Managing Director
- Brian Worrell; Baker Hughes; CFO

PRESENTATION

James West: Good morning, everyone, and thanks for joining me for this next session. I'm pleased today to have with me Brian Worrell, Baker Hughes Chief Financial Officer. Prior to the merger between Baker Hughes and GE Oil and Gas, Brian served as the CFO of GE Oil and Gas, and previously was the vice president GE Corporate Financial Planning and Analysis. More importantly, however, Brian is a fellow Tar Heel and a graduate of the University of North Carolina where, like me, he also earned a degree in economics. However, his degree is with honors, which means he studied a lot harder than I did.

Baker Hughes is in the midst of a transition as it seeks to lead as an energy and industrial technology company supporting the dual challenge of meeting increased energy demand while simultaneously reducing associated greenhouse gas emissions. So we're going to plan to cover a lot of ground here today in the Company's ambition surrounding these themes. Brian, thanks for joining me.

Brian Worrell: Great to be here, James.

QUESTIONS AND ANSWERS

James West: So Brian, last year Baker really accelerated its focus on its key growth areas, accelerated partnerships and collaborations with some of your [valuable] customers and employed capital to strengthen your position as a leading technology company. Could we do a quick year in review? What were the key milestones? What's working better than you expected, and maybe what needs more time to gestate?

Brian Worrell: Yes, James. Look, I'm very happy with the success in '21, both from a strategic as well as a financial standpoint, and as you know, we took a number of steps to really accelerate the strategy and move the Company forward. So one of the biggest things we talked about, really, was operating the Company and looking at it in two broad business areas, oilfield services and equipment and then industrial energy technology. And look, this really sort of kicked off an internal process of we were looking at how do we further optimize the operations, given that we know that the markets that we're operating in are really moving at different speeds, so excited about that work.

And really the first tangible result with that that we've talked about is the creation of Climate Technology Solutions as well as Industrial Asset Management that we talked about in the Fourth Quarter Earnings Call. On top of that, we did some acquisitions that really improved our industrial asset management capability, we acquired ARMS Reliability, invested in a partnership with Augury, and this really ticks up our software capabilities, adding that to Bently Nevada and System 1, so it really gives us a meaningful step forward in creating that industrial digital capability set, and growing from a really strong base from asset performance management. As you know, we also invested in the new energy front, we completed some early-stage technology investment, most notably in Ekona and Electrochaea.

We formed some partnerships, and I think one of the most meaningful ones -- and we've already seen some early wins around Air Products, around green hydrogen, and as you know, we completed the joint venture with Akastor with our subsea drilling systems business to create HMH, which I think is a much stronger player and can take advantage of some of the things going on in the deeper water space today. Orders were really strong on the Bacchus LNG planned activity. TPS booked orders of 7.7 billion, which is just below where we were in 2019. We saw some energy transition orders start to come through with new energy orders around $250 million.

And look, as you've heard us say, we think we can create over the next decade a business that's got $6 billion to $7 billion in orders just in new energy, so almost another turbomachinery inside of Baker Hughes. And then I'd be remiss to not talk about what we did from a free cash flow standpoint, generating $1.8 billion, returning almost $1.2 billion back to the shareholders with the amounts of over $2 billion share buyback program, so coming out of a very tough cycle, a really strong year that positions us well for quite some time here with a very shareholder-friendly return policy. So I think a good '21, and a good start to '22.

James West: Starting last year with your partner in crime Lorenzo, you started talking to the market about the two different strategies and the capital [allocation] priorities as you aligned the Company closest to broad business areas of oilfield services and equipment or OFC, and industrial energy technology or IET. Could you talk a lot more about how you see these businesses evolving over time, their growth trajectory, the capital, M&A needs, and how the management team envisions the future of these two areas?

Brian Worrell: Yes, look, James, again, we put these together to really give us optionality from a capital allocation standpoint and an overall structure standpoint, and how we think about these businesses and in going to market. So the end goal here is to really develop the best business and corporate structure that allows us to continue to operate efficiently, accelerate growth, continue to increase returns in both segments, with very different in-market dynamics, and ultimately it's all about increasing that profitability and return on invested capital so we can return capital to shareholders in an incredibly efficient way.

So look, I think the thing to think about in these different areas is over time, they do have different growth trajectories and investment needs. So oilfield services and equipment has strong cyclical tailwinds coming into this year, but obviously more mature growth profile over the next five to 10 years as oil demand slows. IET should be much stronger, should have a stronger growth profile driven by, really, new LNG orders as well as the installed base growth in services just from the orders that we booked over the last couple of years, not to mention what we see coming down the pipeline, and then growth in both hydrogen and CCUS, as well as growth opportunities in industrial asset management as we build out that platform.

So anyway, from a capital and M&A perspective, OFSC is relatively limited growth needs. I mean, look, you've seen us reposition the portfolio, James, and focus on areas where we think we get pretty strong returns and have got a good market position. We're continuing to focus on strong free cash flow generation in OFSC and gross CAPEX should run in the 4% to 5% range of revenue, and on an IET side, really strong capital efficiency and very low CAPEX needs. As you know, I don't really see that changing over time. We've already stepped up our [R&D] efforts, we've built that into the run rate for this year, you've seen us do some tuck-in acquisitions as well as early-stage technology investments, and I think we'll continue to do that probably at the same level as you've seen here.

So nothing big that needs to happen, but we'd like to continue to build out that technology portfolio. And then I'd say one thing to think about as you look at the different pieces of the portfolio is we'll continue to redeploy capital into IET. So you've got OFSC that we'll invest in to make sure it's a strong business and we're growing and [inputting] returns, but we can take some of that free cash flow and redeploy it into IET, where there are some stronger growth opportunities over the near term.

And look, I'd say even though the growth trajectories of the two businesses are increasingly different, there's a couple of things that I just highlight for this group that say it's good for all of them to be in Baker's portfolio today. I'd say the first is a material overlapping customer base. If I go through the top 15, 20 customers, James, for all the businesses, they're almost identical across the group. So they'll be in a different order, but strong overlap. The second is there's some benefits in having the diverse technology and services across the overall energy value chain in the early stages of energy transition, and then with the global scale, diversity, [R&D] capacity, infrastructure capacity, it makes a lot of sense and helps the margins and returns of both businesses to operate under one structure.

But look, we'll continue to evaluate how these markets unfold, how you in the investor community looks at each business and values each business. We're excited about the opportunities in both spaces, and how the leadership team is addressing it.

James West: Definitely unique in our coverage universe. One thing that you alluded to in your commentary was your returning capital to shareholders, and Baker has been very committed to that over time. You were the only major oil investment company to maintain your dividend during the downturn and through share buybacks as well; at the same time, you've been using capital for strategic acquisition. So what should we expect from Baker going forward?

Brian Worrell: Yes, look, when I take a step back and look at it, James, our goal is to really find the right structure and balance that can help accelerate growth in these strategic areas we just talked about, while also enhancing profitability and increasing shareholder value, and a big piece of that equation is returns. And as I said, we returned almost $1.2 billion in 2021, and for context, we generated about 70% of free cash flow conversion of 2021 adjusted EBITDA. And we returned about 2/3 of that free cash flow to shareholders in the form of obviously dividends and the buyback. And look, we also did about $250 million of tuck-in acquisitions and investments in new energy sectors.

So that feels like a good balance for us, as I think about our returns, and as you highlighted, we didn't have to cut anything, and that was a big priority for the leadership team and the board, and we are definitely focused on making sure we've got a strong balance sheet and can withstand the volatility in this industry. I think if you take a step back and look at it going forward, that strong balance sheet coupled with free cash flow generation should continue, and should allow us to return capital and continue to invest in the portfolio as needed with tuck-ins and technologies. And sort of -- to think about the buyback specifically, we've been doing about $100 million per month since we announced the buyback, James, and I plan to keep that pace up through the -- or into the Third Quarter of this year, and that coincides when GE should be out of the stock if they continue to buy back at current levels.

So if you take what I just said and you look at consensus that's sitting out there, we'd roughly be on pace to return about 90% of free cash flow, consensus free cash flow to shareholders this year, and that's assuming roughly a $725 million dividend. So looking beyond sort of the Third Quarter, as we think GE'll be out, we'll continue to return cash through dividends and buybacks. And I'd say the way to think about it, or the way I'm thinking about it is maintaining consistent dividend, having a buyback floor between $200 million and $300 million annually. So what that does is that kind of sets the floor at about $1 billion, slightly about that, from return to shareholders, and to the extend that free cash flow is stronger, we've got flexibility to buy back more stock or use the capital in other ways.

And I think when I look at sort of best in class in this space, and I say the broader space is where we're trying to take the Company, from industrial to energy technology company standpoint, I think a 60% to 80% return of free cash flow to shareholders on an annual basis is a good way to think about it. Of course, the amount of buyback will fluctuate year in and year out depending on capital needs and what's going on in the markets and what have you, and then we'll continue to have capital for tuck-in M&As as we continue to grow industrial asset management, and as we grow CTS. And then I like how we've invested in some early-stage technologies, and I think that's got a big opportunity to pay off here.

So look, I'm closing this out, James, with saying I think we've been pretty good stewards of capital and we've actually recycled quite a bit of capital since 2017. When I was looked back and adding it all up, we've actually sold in either investments or piece of the business for just over $1 billion, and then we've redeployed just under $1 billion into these -- into these higher growth areas. So have really been transforming the Company by recycling capital, and we've deployed and will continue to deploy some new capital into some of these spaces. But really, really excited about where we are, and are pretty vocal about our commitment to continue to return capital to shareholders. And in fact, we've returned over 100% of our free cash flow since putting the two companies together to shareholders in the form of buybacks and dividends.

James West: So you've also formed, now, the Climate Technology Solutions, or CTS, which you just mentioned, and the industrial asset management, or the IAM, groups to bring together your capabilities, provide some structure for growth initiatives. Could you perhaps discuss why you founded these groups, which businesses and products are in each, and what commercial [and strategic] focus these groups will have?

Brian Worrell: Yes, sure. Look, as I said, it's sort of the evolution of what we talk about in terms of looking at the business with the two distinct markets, and we're pretty happy with putting these groups together, and they're going to report into Rod Christie, who also leads TPS. And look, while we've been focusing on this area for quite some time, we felt like it was important to put these groups together for a couple of reasons -- one, there's some formal structure and leadership and accountability in these areas. We really want this team to focus on building out our product and service offerings here, and really bring the power of all of Baker Hughes together to capitalize on what we see is (inaudible) of market. So they're going to be focused on go to market strategy, how we create partnerships and alliances to really drive focus and attention in these two big areas.

So the way to think about it is CTS, the Climate Technology Solutions team, will really bring together four of the growth focus areas -- so it's hydrogen, CCUS, emissions management and clean integrated power solutions. And then Industrial Asset Management's going to pool together all of our digital software and hardware capabilities that focuses on that Industrial Asset Management ecosystem to, again, figure out what the right service offering is, what the right go to market strategy is, and ultimately how to build out a stronger software as a service business.

So look, we're not starting from scratch in either space, particularly in IAM. That team's going to work closely with TPS services as well as Bently Nevada from a System 1 standpoint, as well as the two acquisitions and investments that we've made around ARMS Reliability and Augury, as well as what we're doing with C3. So we're coming at this from an asset standpoint, where we do outstanding asset performance management on an individual piece of equipment. We're expanding that to more the broader plant and platform and have got some really strong partners there to help us build that out.

And as you know, James, in Climate Technology Solutions, we've been around hydrogen and carbon capture for a number of years, but with the growth and the different customer bases that we think are going to come to play here, and just where the markets are, we felt like it was the right thing, to have some very senior leaders who woke up every morning and thought about this and are kind of unburdened, if you will, by some of the other structures and things that we have in place for our more established businesses. So there's real-time communication, fast decision-making, and this team is empowered to go out and build a set of offerings that we think can win in this very fast-paced market that we see evolving here.

James West: Great. Well you alluded to some of these things, but you've announced a number of new partnerships and collaborations in CCUS and hydrogen, clean integrated power. Could you discuss (inaudible) the rationale, the drivers for the main ones, the intention, and then the vision for this. What is the end goal or end game for these partnerships/collaborations?

Brian Worrell: Yes, look, the ultimate goal here is to build upon the current products and core competencies that we have in turbine and compression technology as well as overall system integration to provide those process solutions that we think are going to be needed and going to win as these -- as these markets develop. So look, broadly speaking we're evaluating the entire value chain of hydrogen, CCUS, clean and integrated power to really assess how our technologies can provide things that should drive greater efficiency and cost improvements, and ultimately be able to command strong returns, James, as this ecosystem is built out.

So we think there's a huge market to go after there, but we are really focused on those areas where we think we can drive the most value, leveraging what we do internally today and looking at technologies that are going to be needed to integrate to what we do today. So I'm not just going to be a wrench turner in this phase; we want to provide that key technology like we do in LNG and other turbocompression applications today.

So if -- to give you some perspective on it, I'll walk you through a couple investments if that's okay. And the first one I'd say is compact carbon capture, which is one of the earliest ones that we did back in 2020. So this is technology that utilizes centrifugal acceleration to intensify mass transfer, so it can be applied to any solvent based post-combustion carbon capture, and the goal here is to really reduce the footprint and increase the efficiency of carbon capture. And it's really designed for small and mid-scale projects that can be quickly deployed to capture (inaudible) gases from a number of sources.

And so the types of industries I think about for that are the offshore industry, cement factories, gas turbines, [wasted] energy plants. The list goes on and on, but very good for sort of retrofitting because of the small footprint that's needed and the increased efficiency. But look, for it to become fully established, we need to continue to drive down the cost of capture and make it more accessible. At the same time, the regulatory framework around carbon capture needs to come up as well, but we think this is a technology that definitely (inaudible) as we continue industrialize it and commercialize it.

Another example that we did last year is the Ekona, which is a growth stage company that is developing a novel turquoise hydrogen production capability. So turquoise hydrogen is made from methane-using pyrolysis, which is basically cracking, and so if we're going to help Ekona accelerate the industrialization of that technology by helping them identify some suitable projects, we've got about a 20% stake in Ekona, and then as soon to [see it] on the board. The great thing about this technology, in turquoise hydrogen, is it can utilize the existing infrastructure -- existing gas infrastructure where H2 is needed. So that obviously takes down the cost of using hydrogen quite a bit.

And then most recently, we announced a partnership with NET Power, or an investment in NET Power. We got a minority stake there. Their other partners, they are like McDermott and Constellation and Oxy. And so NET Power has gas to power technology that basically enables clean power plants to operate with pretty high efficiency that produces only electricity, water and pipeline sequestration-ready CO2 that's permanently locked away from the atmosphere. So our focus there is going to be around the CO2 turbine expanders -- turboexpanders as well as overall process integration.

So I think what you'll see from all of those is we're leveraging core capabilities that we have, integrating new technologies to further develop a market, and we think we can -- we can go in and do this and get pretty strong returns for Baker Hughes. I'd say in other areas around partnerships -- and we've done quite a few, but the most impactful so far has really been our partnership with Air Products on green hydrogen, leveraging HPRC compression technology. We've already announced a few wins there, we've got exclusivity for green hydrogen, and then we're well-positioned on blue gray and hydrogen with Air Products around the world.

So the strategy here is to continue to be a meaningful player in industries that matter as the world moves to lower carbon energy. And I think that you'll see that we are placing bets in some key areas and we'll see us do some more technology investments. And James, I'm fully aware that all of these are not going to be as successful as others, and so that's why we're building a portfolio here at this early stage, learning as we go, and we believe we can help shape the market just as we did -- if I go back to LNG, and help shape how that market has developed over time. So pretty exciting. I think there's a lot of opportunity here in the second half of this decade for a lot of these new areas. But as you know, we're starting to see orders come through today.

James West: You've had -- or Baker has had -- somewhat of a different view on offshore and subsea relative to one of your major competitors in both product areas there. Could you explain some of this differentiation of what you see that maybe they don't, or maybe I'm a little too nitpicky and it's all relative?

Brian Worrell: Yeah, I think it's the latter, James. Obviously - it is relative. We just have a different view on the overall industry and where it's headed. But look, I will say that we do see growth in offshore activity in orders this year. So we said on the last earnings call that we expected the market to take another step higher this year, but will likely remain well below pre-pandemic levels on a sustainable basis.

But if I look across the entire portfolio and assess the near and long-term growth opportunities, and look at overall profitability and returns, the offshore outlook is just not one of the most exciting areas, unfortunately. And I do believe that is an industry issue and not is unique to Baker. So when I look at how we're allocating capital and compare it to the outlook for [subsea trees] versus what I can do in LNG or CCUS or hydrogen or parts of digital solutions, the outlook offshore really ranks below those areas. So we're going to operate that business incredibly well and we'll continue to go after business that makes sense, but it's not an area that's going to attract a lot of -- a lot of incremental capital.

So look, if the market does perform better as some are saying, we'd certainly welcome that, and I think we would -- we would certainly be there to take advantage of that. But look, I'd say as far as recovery goes, it's off a very low base, and as I said, I still think there are structural complications in this space. I mean, customer budgets and uncertainty over how the deep-water market's going to be over the next five to 10 years is -- as companies focus on new energy raises a lot of questions, and look, I'd say that one of the bigger issues is that even the companies that are capturing the biggest market share of this space are only delivering mid-single digit EBITDA and returns following suit.

So look, I don't disagree that it's recovering. I don't talk about it that much because it's relatively small, and that other parts of the business are attracting more capital. I'd be happy to see that industry do better, and I think we've done a lot to take costs out and remain incredibly competitive there, but as you saw what we did with subsea drilling systems, that's a -- that's a great business, it's just better off being with HMH and in a much stronger position together. So (inaudible) and the team are doing a great job running what we have; I just think relative to other opportunities, it's just not as attractive as what we have in the rest of the portfolio.

James West: Fair enough, fair enough. The outlook for LNG has clearly brightened somewhat dramatically over the last several months, not only with the natural gas shortages that we've had in Europe, the E.U. recognizing natural gas as a clean fuel, but also of course what's happening in Ukraine and putting the spotlight on Europe's reliance on Russian gas. What are the main trends you're seeing, and how should this impact TPS this year, then really in the coming three to five years?

Brian Worrell: Yes, James. Look, as you know, we've been quite constructive on LNG for some time, and coming into this year, a lot of external folks moved their view of demand in 2030 to 600 million tons, which is where we have been, because we do believe that natural gas and LNG specifically is going to be the transition fuel, and I think it's going to be the destination fuel in a number of instances. So look, some things have happened that have certainly made that more solid, the recent E.U. taxonomy included, natural gas and nuclear, which we think is a positive development. I think the world -- given the horrible things that are happening in Ukraine right now, they're totally refocusing on energy security and reliability.

And even before that, we talked about seeing the potential for LNG awards coming in larger this year, but I think it reinforces the outlook for more LNG awards in the next two to three years. And so if you think about -- if you think about that, if the world needs 600 million tons per annum by 2030, there's got to be another 100 million to 150 million tons per annum over the next few years with the bias towards the higher end of that range to hopefully meet that demand that's required. And look, I believe you could see demand forecasts go up quite a bit from that given everything that's going on, and I'd say the thing you got to think through with that is we were well-positioned on a number of different technologies within LNG, and modular has shown some tailwinds and it's got the advantage of being able to get gas to market faster than traditional (inaudible) projects, talking about two and a half to three years versus five years, so you can see some uptick in that.

And with all of this backdrop, I think we'd expect that to translate into strong multi-year orders environment for TPS. And then James, if you think about that, we'll continue to add to the install base, and that's going to grow that service pool significantly, which would be up to about you know, [a third] just in 2025 with everything that's already in construction and is due to come on today. And look, although we've said that TPS orders are likely to be flat year over year, I'd say based on the demand and things we're seeing, I could see orders being up this year, which would obviously have positive implications for '23 and beyond.

And I'd say the one thing I'd point out about the LNG mystery is there are plenty of projects out there to meet this demand. I actually have projects in excess of what this demand is. So I think you'll start to see a lot more off-ticket agreements and commitments come through, and likely to see an acceleration of projects, and then there are quite a few on deck if the demand does go up beyond 600 million tons per annum. So in general, a pretty positive outlook here. I think we're incredibly, incredibly well-positioned, and are excited about what turbo can do in this space.

And look, James, there's a lot of activity outside of LNG in turbomachinery as well. We've seen an uptick in FPSOs and a lot of activities in the industrial space as well, so given where we are today, a strong backdrop in terms of demands. Now there's a lot going on broadly in supply chain, you know, and the conflict in Ukraine has certainly intensified that, so we'll see how hydrocarbon demand as well as what's going on with supply chain impact things over the short run, but the broad term macro-outlook is pretty strong for TPS, and particularly LNG.

James West: Fine. A great conversation. Always insightful to talk to you and get your thoughts on the business. Any parting words of wisdom for us?

Brian Worrell: Yes, James. Look, I think we have been focused on increasing returns and margin rates across the portfolio, and I think you've been with us this entire journey--

James West: Yes.

Brian Worrell: and seen how this team has been focused on that. I do believe that there is -- there's more to come there. We've been doing a lot internally to continue to improve all aspects of the business here. And I think as demand returns, you'll see some strong volume leverage as things get back to pre-pandemic levels, just given all the work that we've done, not only because of the fall-off in demand, but more importantly, the fundamental changes that we've been driving across the portfolio, particularly in oilfield services.

And the only other thing I'd point out is we believe that our compensation structures are completely aligned with investors on a short-term basis -- the biggest metric we have is around free cash flow -- and long-term it's return on invested capital improvement as well as the free cash flow conversion and TSR. So we think we're completely aligned, and this team is focused on delivering.

James West: Thank you, Brian. And thanks again. I'll let you get back to it. Thanks for joining me today. This is a great conversation, and I'll look forward to catching up again soon.

Brian Worrell: Great. Thanks a lot, James.

James West: All right. Thanks, Brian.