Baker Hughes Company | Goldman Sachs Energy Services Symposium 2022 | March 9, 2022

Neil Mehta:

All right. Terrific. Well, we are very excited at the first session of the day with Baker Hughes, with Lorenzo. Lorenzo, thank you so much for being here.

Lorenzo Simonelli:

Neil, it's great to be with you. Looking forward to the discussion and hopefully this being one of the last virtual sessions we have.

Neil Mehta:

Hopefully, we'll never have to do it this way again. So look, Lorenzo, when we talked about this, we said, "Let's talk a little bit about unlocking some of the parts value in managing the energy transition." Two really important topics. So let's dig into that, but before we do, let's turn the floor over you to talk about what's top of mind from your seat.

Lorenzo Simonelli:

Well, look, I think clearly the energy transition and for Baker Hughes unlocking the evaluation of the company is very important. We live in some volatile times, so I think it goes to say that what's happening in the world today, the humanitarian aspects, obviously we don't condone what's taking place and we are managing through it like everybody else and staying focused on where we're taking the company. And as an energy technology company, we think that the future's bright in our two business areas. So looking forward to our discussion on that today.

Neil Mehta:

Well, that's a great place to kick off on the some of the parts value that the business carries. We think your stock is worth more than what the market's giving you credit for, but we recognize some energy companies don't always trade to their some of the parts values. So you're in the process of evaluating the structure of your own business. Can you talk broadly about the evaluation process with the assets you currently own and what directions you want to take?

Lorenzo Simonelli:

Yeah, definitely, Neil. And I think, first of all, I'd agree with you and your assessment, and ultimately we want to deliver maximum value for our shareholders and will consider all options to achieve that. Back last September, we signaled that we had two broad business areas. One being OFSE, which is really our Oilfield Services and Equipment side, which is more focused on the upstream, the extraction and production.

And then another side of Industrial Energy Technology, IET. And it makes a lot of sense for us to start to look at the four product companies within those two business areas, as it provides us the most optionality long-term. Over time, we see both of these business having distinctly different growth trajectories. And just maybe starting off with the OFSE side, as you can see with what's happened in the world, there's strong cyclical tailwinds today that are taking place as demand returns, and also the necessity for oil and gas, but a more mature growth profile over the next five to 10 years as demand slows, and also as the energy transition continues to occur.

As you look at Industrial Energy Technology, IET, it's going to have a much stronger growth profile driven by LNG orders and the growth of also our installed base for services, growth in hydrogen, CCUS, and the opportunities that we have around Industrial Asset Management. So much more a longer-term growth trajectory as we see the energy transition, not only in oil and gas, but across multiple industries that we serve and can help people actually achieve their net zero roadmap. So we believe, just as an example, hydrogen and CCUS could be a $6 to $7 billion business by 2030.

And that would imply a CAGR growth of high single digits to low double digits for the IET business as we go forward. So at the time we made the announcement, we did indicate that it would take about 12 to 18 months to complete the internal plumbing, understanding the organizational evaluation necessary for making that long-term decision. We see synergies keeping it together at the moment. And at the end of the day, the goal is to create the best business and the corporate structure that allows us to operate efficiently and accelerate growth in our key strategic areas. So we're going to continue to evaluate, continuing to look at the various aspects and also managing through the changing landscape.

Neil Mehta:

Ati?

Ati Modak:

Yeah. Lorenzo, so you created two new groups on the industrial side of the business, right? So you have CTS, which is Climate Technology Solutions and IAM or Industrial Asset Management. You also identified a few assets for these two groups. Can you talk about those businesses and how they align with these two new groups? As you think about these two groups eventually, is there room for expanding the portfolio offerings and what kind of assets would eventually be of interest?

Lorenzo Simonelli:

Yeah. Great. And look, I'm very pleased with the creation of these two new groups, CTS, as you mentioned, Climate Technology Solutions, and also IAM, Industrial Asset Management. And both reporting into Rod Christie, and really both part of the journey that we started. And in 2019, we said, "We're an energy technology company." We indicated the two broad areas in September of 2021 relative to OFSE and also the IET side of the house.

And within IET, we really see an opportunity continue to grow around Climate Technology Solutions, and also Industrial Asset Management. And if we break into those, really, if you look at Climate Technology Solutions, it's the bringing together our four growth focus areas that we've had over the last couple of years, hydrogen, CCUS, emissions management and clean integrated power solutions. And we're going to continue to build a roadmap and commercial offerings that assist our customers, both within the oil and gas area, as well as other industries to achieve their net zero.

And this is from the capabilities of switching to hydrogen, allowing CCUS to be implemented, capturing the information around methane, CO2 emissions, greenhouse gases. And then we see clean integrated power off the grid as being a key growth trajectory as people want to have assurances of clean energy being supplied at the affordable rates.

On the Industrial Asset Management side, what we're doing here is really focusing on efficiency and uptime. And as you look at operations, we are bringing together our digital software and hardware capabilities from across Baker Hughes to develop an integrated Industrial Asset Management ecosystem, to go to the market really from an energy and industrial standpoint.

We've been very good at single point solutions, such as looking at condition monitoring vibration. We've got valve management, we've got our services business in TPS. Now, we can enhance that by bringing it all together. And so we're going to be bringing together our TPS capabilities in the service of monitoring the gas turbines, our Bently Nevada System 1 from vibration monitoring, ARMS Reliability, Augury, which is a great partnership, and also C3.ai from an artificial intelligence perspective.

So we are really going after a wing-to-wing approach of driving efficiency in the actual process side, and actually looking at wing-to-wing process. And we think that's going to achieve significant growth, and also allow people to reduce their emissions, but more importantly, continue to drive uptime and efficiencies, which is what the market's placing a lot of emphasis on. Regarding future M&A that you asked, our goal is to continue to build on the current products, the core competencies we have around turbine and compression technology. And we are already stepping up our R&D efforts as we invest in new technologies. And we do have opportunities for tuck-in M&A.

You may have seen some of the investments we've made in early stage technologies, Ekona, Compact Carbon Capture, also Electrochaea, et cetera. And we see this as being a key way in which we're going to continue to develop industrial software and technology around hydrogen and CCUS.

Neil Mehta:

Lorenzo, we'll pivot back to some of the strategic stuff here in a moment, but there's some top of mind topics based on current events and some news releases that we want to get into with you, including this morning, just before the session, you announced a new project when around LNG. So, talk to us a little bit about that and how that fits into your broader LNG strategy.

Lorenzo Simonelli:

We've been strong believers in LNG and in natural gas, and we've said there is no energy transition without an increasing use of natural gas and also the growth in LNG. And in fact, natural gas is both a transition and destination fuel. And I think with the events that have taken place over the last year, also from the winter storm in Texas, to also the necessity to continue to diversify the dependence of the energy mix away from coal to cleaner solutions, you've seen the increased opportunity of natural gas and LNG.

This morning, we were pleased to announce an award for Venture Global's LNG Plaquemines project. And again, this is going to be a 24 modularized compression trains across 12 blocks. And it's part of the master agreement we have in place with them. We see that LNG is going to enter into, again, another supercycle. And as you look at some of the recent geopolitical situation, we think it's going to be accelerated in particular around US LNG. And we stand by our conviction that by 2030, there's going to have to be an installed base of approximately 800 MTPA to satisfy the needs of the world. And we are seeing a lot of project activity. And if anything, with events that are taking place that may be accelerated and increased as we go forward. But we are long on natural gas and LNG, and I think we've got a unique position just given our strong historical capability technology differentiation in really manufacturing and designing the liquefaction trains.

Neil Mehta:

Yeah, very clear the world needs more of it. And then the other topical issue is Russian's, probably something you've been spending a lot of time on, I would imagine, over the last couple of days. For your investors, can you help us calibrate, what percentage of your mix is Russia exposure? What products and how do you think about the go forward there?

Lorenzo Simonelli:

Yeah, Neil, it is something that's very much occupying my time and spending a lot of time also discussing with others on how to approach this. And as I mentioned at the beginning, clearly what's happening in Ukraine is a humanitarian disaster. And we don't condone that, and we abide by all the sanctions and the rules of law that are in place. And we work closely with all of our stakeholders.

As you look at Russia, specifically, the revenues range between 3% to 6% per year. It's dependent on some of the order flow over the past few years. And as you look at our activity, our businesses of Oilfield Services, in particular with local activity in the extraction and the production of both oil and gas. And as you look at TPS with the aspect of some of the LNG projects that are already in place and looking for development as we go forward. And then Oilfield Equipment with some of the offshore development that's been taking place.

We have an installed base. We have a project backlog. We continue to support our customers through the commercial agreements that we have in place. And we obviously abide by all the current sections. So it's a dynamic situation at the moment. We're continuing to, again, ship products that are required and also allowed, and continue to monitor the situation very closely, and don't condone what's happening in the Ukraine.

Neil Mehta:

Yeah. And the 3% to 6% in revenue is similar EBITDA margin to the rest of the business. So it's fair to say that's the EBITDA impact as well, potentially.

Lorenzo Simonelli:

Yeah. It varies, again, by the project activity. And I'd say, yes, it's in line with the EBITDA of the business.

Neil Mehta:

Okay. Very good. Ati.

Ati Modak:

Yeah. So, I mean, on the traditional oilfield side, if we can touch there a little bit, is there room for maybe an inorganic opportunity that you may think that enhances the production-oriented nature of the business so that you can drive a greater return of capital strategy as you think about the competitive positioning versus other stocks?

Lorenzo Simonelli:

We've been very focused in our Oilfield Services to stay really on our strongest, most differentiated product lines, where we can drive sustainable returns and have confidence in the technology advantage. So as you look at our rotary steerable, artificial lift, chemicals, as well as digital innovations around remote operations. So we feel we've got a good large presence in both artificial lift and chemicals. I don't see much M&A, but we'll always stay on the lookout if there's a technology differentiation that can add and bolster our capability within these areas that we're already strong.

Neil Mehta:

Great. Let's pivot over to Industrial Energy Technology and start on carbon capture. You have compressors in your portfolio and have some other equipment around carbon capture. Can you talk about the spectrum of offerings that you have for CCUS and where you think your portfolio eventually is going to evolve to? And Lorenzo, do you eventually see room for the full spectrum of carbon capturing offerings across both sides of the company?

Lorenzo Simonelli:

Well, definitely. I think Baker Hughes is really uniquely positioned to benefit from opportunities in carbon capture. And when you look at the portfolio, really, we have a unique portfolio that plays across the different areas. And if you think about post-combustion capture, compression, subsurface storage services, like, well construction and reservoir modeling, long-term integrity and monitoring and utilization.

And I think people forget that we've been in the aspect of CCUS for many years. If you look at our compression capability, we've been working with CO2 for over 50 years, and also a similar timeline for hydrogen as well, which I'm sure we'll get into. I think the capability we have is also evidenced by the Moomba CCS project in Australia with Santos that we announced earlier on. And today we've got a full portfolio of compression to actually help from the pumping products and also the full spectrum of CO2 applications.

So I view it as a very attractive area. And I agree with you, we're going to see continued focus on high pressure reciprocating compressors, which allow higher flows, and centrifugal compressors. And our portfolio will continue to be very attractive in these areas. As you look at capture, again, from a capture standpoint, we've been focusing on new technologies, we've got a chilled ammonia process, which again, our equipment is adapted to.

We've got 3C which we've mentioned before, Compact Carbon Capture, which really utilizes rotating bed technologies. And it can be used in the offshore industry, in cement factories and shipping. It's really a nice modular approach towards CCUS. And also as you look at the mixed salt process. So during the course of the last years, we've developed a broad range of technologies and capabilities for capture. And on utilization, I think it's ... Our compression technology really allows us to compress carbon into a liquid-like substance, which makes it easier for transport and reuse.

We've also invested in a company called Electrochaea, which utilizes carbon to combine with methane, to create synthetic natural gas. So we see this as being a huge opportunity. To your point, it really is the full wing portfolio. And I think we will see opportunities to really provide carbon as a service. And I think as you go to certain industry segments, and in fact, as you look outside of the oil and gas sector, companies are going to view it like waste management. And CO2 or greenhouse gases and emissions, they're going to look for providers and partnerships that can actually take it off their hands and deal with it.

And that's something that we're exploring from a commercial model perspective with different partners. You've seen our announcement around Borg CO2, Horisont Energi, and we think that's a market that's developing.

Ati Modak:

Great. Lorenzo, you mentioned that the CTS segment will house a few technologies and one among them being emissions management. What are your key areas of focus here, especially as it comes to your capabilities around monitoring and managing methane emissions? How big of a market do you think this could be in the US and internationally for that matter? And what are the catalysts for this market to start picking up?

Lorenzo Simonelli:

Well, I think, just look at what happened yesterday and the OGCI made an announcement relative to a methane commitment. And if you think about emission management, and you think about how it fits into Climate Technology Solutions, you begin by detecting and understanding where the emissions are.

And so within our emissions management, we've got the capability to assess and understand what the greenhouse gas footprint is in different operations. We've got capabilities such as Avitas, with drone and land-based sensors to be able to detect methane leakage. We've got the opportunity to see the CO2 content, and again, capture that information. So emissions management starts off with the detection. Then you start to work towards, "Okay, how do you avoid the actual methane or the CO2?" And then you have products and solutions such as flare.IQ for flare stacks, which actually reduce the methane that's being flared.

And we see this as a big opportunity as well in line with what the OGCI announced relative to being able to take, at the entry point, the emissions away from the process. If you take it a step further, then on CO2, and also the ability to reduce the carbon footprint and greenhouse gases, you move into CCUS, you move into hydrogen, and you move into clean integrated power systems. And that all in all starts with the emissions management, because you understand what you're going after.

And we think as the world goes forward, there's going to be more requirement for certifications and also probably likely more regulatory aspects that require you to understand your footprint of greenhouse gases. So we like the way Climate Technology Solutions has all four elements, and it starts with emissions management, but then obviously goes into the CCUS, the hydrogen and clean integrated power.

Ati Modak:

That's great, Lorenzo. Thank you for that. So when you think about the emissions management offerings, it has the potential to leverage digital assets from the Industrial Asset Management side of the segment, as well as synergies in the oilfield offerings that you have on the traditional side of the business. How do you think about this offering? Will it be an integrated offering across these segments and the eventual entities that you would think of? Will it be all from the CTS side of the industrial business?

Lorenzo Simonelli:

No, and I think it will actually stem across the overall traditional offerings as well. We'll start to connect more and more, and we have over 15 technologies today across Oilfield Services, Digital Solutions and Turbomachinery & Process Solutions that reduce emissions. And so what we're looking to do is within emission solutions, really find commercial value for our customers in OPEX, as well as productivity and CAPEX savings.

So we plan to actually go across the board with our customers, and Baker Hughes brings the actually emission solutions to traditional areas as well. And I go back to a flare stack; we've got our Oilfield Services team that's out there in the field, understands where flaring's taking place and they'll link into emissions management. Likewise, our TPS sales force, which is in refineries and seeing the leaks that are happening, we'll be able to go in there with the capabilities and link it into Industrial Asset Management. There is a very clear linkage also on the digital side of things where you can now start to use that ecosystem of better productivity, efficiency from software to reduce your carbon footprint, reduce greenhouse gases once you understand them. And that emission management solution allows you to understand the foundation.

Neil Mehta:

Lorenzo, let's talk a little bit about the hydrogen opportunity. You had mentioned that earlier. How do you think about the technologies that are in your portfolio? And then maybe to step back, you've talked about carbon capture. You've talked about hydrogen. You've talked about LNG. How do you think about the sequencing of these businesses and when they scale and the cadence of the opportunity there?

Lorenzo Simonelli:

Yeah, I think ... And again, we've been on a journey, and I think energy transition is a transition because it will take time and it'll evolve over time. And just like LNG has evolved, so will the elements of compact carbon capture, as well the benefit of hydrogen evolve. And we've said that by 2030, CCUS and hydrogen represent a $6 to $7 billion opportunity for us in an addressable market of $60 to $70 billion.

And if you think about the sequence, clearly, LNG right now is on an upcycle. And you're going to have a lot of LNG projects that are sanctioned over the course of the next one to three years. We've said that there's as much as 100 to 150 MTPA that's going to be sanctioned going forward to achieve the required installed capacity for 2030. And with that, then you're going to start to look at how do you reduce spending? How do you employ some of the flare.IQ? How do you employ zero methane leakage? E-drive solutions? And that will be the first start.

The second start is, of course, utilizing CCUS from a standpoint of the energy transition within LNG as well. And we are one of the first to have made investments here in 2020 on the offshore industry. And we see that LNG will go towards CCUS and compact carbon capture. And the technologies I mentioned before are going to be the first movers. Then if you think about from CCUS, LNG, you're going to see the emergence of hydrogen. And you may have seen that we announced also an investment in Ekona, a growth strategy company developing novel turquoise hydrogen production technology.

And if you think about that, it's a huge way of complementing really the ability to start to use hydrogen in the energy mix, and also to create a carbon offset as well as a carbon black opportunity. So we see great benefits of turquoise hydrogen. Also, we see blue hydrogen, as well as green hydrogen. You may have seen that we're on the largest blue hydrogen project in the Canada, Edmonton, as well as the largest green project hydrogen in the Kingdom of Saudi Arabia.

So we see that those are continuing to develop, and also recently we announced NET Power, and that was our latest transaction, couple of weeks ago. And with our partners, we see that we'll be able to provide super critical CO2 turbo-expanders used to generate power. So then you start to go into the clean integrated power aspect and reducing the carbon footprint. So it's a logical sequence of steps, and as you look at our growth, we already announced the orders in 2021 of over $200 million in the energy transition. We said that it could well be between $100 - $200 [million], more the upper end there. It's going to be lumpy, I think, if anything, it will be accelerated as we go forward. And again, we see that pipeline of opportunities to get to the $6 to $7 billion business being created by 2030.

Neil Mehta:

Lorenzo, let's spend some time on the financial side of the equation, both capital returns and then free cash flow conversion. You've come out with EBITDA guidance, I believe, of 50% EBITDA to free cash flow. How is that on track and how should we think about the free cash flow of the power of the business in ‘22, recognizing ‘21 was a pretty good year for the company on that basis?

Lorenzo Simonelli:

Yeah. Look, first of all, very pleased about the performance by the team on 2021, relative to cash generation. And we have obviously a buyback in place, and right now we're on a pace of a $100 million per month. We plan to keep that pace probably into the third quarter of ‘22, which is when we think GE should be finished with their sell down process.

So if you think, that suggests we're on pace to return roughly 90% free cash flow back to shareholders in 2022. And that's based on current consensus estimates. If you take into account our dividend, which will be around $725 million this year at the current pace of the buybacks. Looking beyond GE, we think about capital returns in three broad buckets, and that's cash return to shareholders by our dividends and buybacks. We're going to be maintaining a consistent dividend buyback, at least $200 to $300 million in stock on a yearly basis.

We've got $1 billion minimum in shareholder returns. And to the extent free cash flow is stronger than a billion, we'd have flexibility to buyback more stock or other uses of capital. So overall, we generally expect to return 60% to 80% of free cash flow to shareholders every year, but with a floor of about $1 billion, and the amount will fluctuate year to year depending on the valuations and other opportunities. Tuck-in M&A, we're going to look and focus on small companies generating revenue and positive EBITDA. Early stage companies with scalable technologies that complement existing portfolio extremely well.

And we like to fund these through investments, through a combination of debt and cash on hand. If you think about examples of acquisitions, like ARMS Reliability and PolyFlow that we've made. And then thirdly, strategic or early-stage investments. And these are likely pre-revenue, and we'll target investing $300 to $500 million in this area, over the course of next three years. And we're likely to fund these investments through cash on hand, and examples are such as Augury, Ekona, that we've mentioned, NET Power.

And so, as you think about it, we've got a continually opportunity to recycle capital with M&A. Since 2017, we've generated about $1 billion in asset sales, simplifying our portfolio, exiting low return and non-core activities. We've also deployed around $1 billion in tuck-in M&A and investments, better positioning our company. And we also look at our dividend, but buybacks are more likely option near-term to return cash to shareholders.

So we're committed to returning cash to shareholders since the company was formed in 2017. Last year, we returned almost 65% of free cash flow to our shareholders. And again, as I mentioned at the beginning, if you look at the consensus free cash flow estimates for ‘22, we're on pace with that and have solidly said that we're going to return roughly 90% of free cash flow to shareholders. So I think overall, since the company's been formed, we've returned over 100% of free cash flow back to shareholders on average free buybacks and dividends. And that's the way we really look at the aspects of cash returns and shareholder returns.

Neil Mehta:

And Lorenzo, from your comments of thinking you're stuck is undervalued. And the fact that you're prioritizing buybacks, is it fair to assume that if you are in a robust free cash flow environment in the back half of the year, once GE has exited, that a buyback is a more likely use of incremental cash than dividend growth?

Lorenzo Simonelli:

Yes. And as I said, we'll always continue to evaluate.

Neil Mehta:

Of course.

Lorenzo Simonelli:

We see the benefit of maintaining a good dividend and remind you, we're probably one of the few companies that did maintain the dividend through what happened in the last few years. And we think that's important as a statement. And as we have extra cash flow, we'll look at the opportunity of further buybacks.

Neil Mehta:

That's great. We only have a few more minutes left, Ati. I know you want to make sure we got to services and equipment.

Ati Modak:

Yeah. One quick question on the OFE side, if I can. I mean, you've taken some steps already that are improving the margin profile of the business and have talked about the opportunity set there. Can you maybe reiterate your expectation of the product lines in that segment? Do you envision anything being retained as you think about the future structure of the business or the traditional side of the business? Or is the idea here to completely exit before you can get to that point?

Lorenzo Simonelli:

So with respect to our last earning call, we expect the market to take another step higher in 2022. And as you look at Oilfield Services and Equipment, in particular on the offshore, it will still remain below pre-pandemic levels for the foreseeable future. So in the subsea space and the tree count, we do expect to perform better. And you can see that by some of the expectations of our peers and partners indicating that there is an upswing, even though moderate.

However, we still think it's structurally challenged. So from a strategy perspective, we are going to continue to focus on EBITDA, the returns, we've had cost out that's been achieved. We've restructured the business and we'll continue to explore other opportunities within the space. We think consolidation would be attractive, and that's something that we'll continue to assess with regards to actually taking some of the excess capacity out of the market. But I think our strategy is, again, run the business well and continue to evaluate on the Oilfield Equipment side.

Neil Mehta:

Terrific. Well, Lorenzo, I know we're at the top of our time. We really appreciate you spending some time with us today. I wish you luck through the balance of ‘22. I'll talk to you on the upcoming call.

Lorenzo Simonelli:

Thank you very much.

Ati Modak:

Thank you, Lorenzo.

Lorenzo Simonelli:

Goodbye.